

## § 74.1

### Subpart E—Special Provisions for Awards to Commercial Organizations

- 74.80 Scope of subpart.
- 74.81 Prohibition against profit.
- 74.82 Program income.

### Subpart F—Disputes

- 74.90 Final decisions in disputes.
- 74.91 Alternative dispute resolution.

APPENDIX A TO PART 74—CONTRACT PROVISIONS

APPENDIXES B—D TO PART 74 [RESERVED]

APPENDIXES E TO PART 74 PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO RESEARCH AND DEVELOPMENT UNDER GRANTS AND CONTRACTS WITH HOSPITALS

APPENDIXES F—H TO PART 74 [RESERVED]

APPENDIX I TO PART 74—OMB CIRCULAR A-133 “AUDITS OF INSTITUTIONS OF HIGHER EDUCATION AND OTHER NONPROFIT INSTITUTIONS”

APPENDIX J TO PART 74—OMB CIRCULAR A-128, “AUDITS OF STATE AND LOCAL GOVERNMENTS”

AUTHORITY: 5 U.S.C. section 301; OMB Circular A-110; Appendix J is also issued under 31 U.S.C. section 7505.

### Subpart A—General

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

#### § 74.1 Purpose and applicability.

(a) Unless inconsistent with statutory requirements, this part establishes uniform administrative requirements governing:

(1) Department of Health and Human Services’ (HHS) grants and agreements awarded to institutions of higher education, hospitals, other nonprofit organizations and commercial organizations;

(2) Subgrants or other subawards awarded by recipients of HHS grants and agreements to institutions of higher education, hospitals, other nonprofit organizations and commercial organizations, including subgrants or other subawards awarded under HHS grants and agreements administered by State, local and Indian Tribal governments; and

(3) HHS grants and agreements, and any subawards under such grants and agreements, awarded to carry out the entitlement programs identified at 45 CFR Part 92, § 92.4(a)(3), (a)(7), and

## 45 CFR Subtitle A (10–1–96 Edition)

(a)(8), except that §§ 74.12, 74.23, 74.25, and 74.52 of this part do not apply. Under these programs, requests to HHS from Governors or other duly constituted State authorities for waiver of single State agency requirements in accordance with 31 U.S.C. 6501–6508 will be given expeditious handling. Whenever possible, such requests will be granted.

(b) Nonprofit organizations that implement HHS programs for the States are also subject to state requirements.

(c) HHS shall not impose additional or inconsistent requirements except as provided in §§ 74.4 and 74.14, or unless specifically required by Federal statute or executive order.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, 11747, Mar. 22, 1996]

#### § 74.2 Definitions.

*Accrued expenditures* mean the charges incurred by the recipient during a given period requiring the provision of funds for: (1) Goods and other tangible property received; (2) services performed by employees, contractors, subrecipients, and other payees; and, (3) other amounts becoming owed under programs for which no current services or performance is required.

*Accrued income* means the sum of: (1) Earnings during a given period from (i) services performed by the recipient, and (ii) goods and other tangible property delivered to purchasers; and (2) amounts becoming owed to the recipient for which no current services or performance is required by the recipient.

*Acquisition cost of equipment* means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the property usable for the purpose for which it was acquired. Other charges, such as the cost of installation, transportation, taxes, duty or protective in-transit insurance, shall be included or excluded from the unit acquisition cost in accordance with the recipient’s regular accounting practices.

*Advance* means a payment made by Treasury check or other appropriate payment mechanism to a recipient upon its request either before outlays

are made by the recipient or through the use of predetermined payment schedules.

*Award* means financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property in lieu of money, by the Federal Government to an eligible recipient. The term does not include: technical assistance, which provides services instead of money; other assistance in the form of loans, loan guarantees, interest subsidies, or insurance; direct payments of any kind to individuals; and, contracts which are required to be entered into and administered under Federal procurement laws and regulations.

*Cash contributions* mean the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties.

*Closeout* means the process by which the HHS awarding agency determines that all applicable administrative actions and all required work of the award have been completed by the recipient and HHS.

*Contract* means a procurement contract under an award or subaward, and a procurement subcontract under a recipient's or subrecipient's contract.

*Cost sharing or matching* means that portion of project or program costs not borne by the Federal Government.

*Current accounting period* means, with respect to §74.27(b), the period of time the recipient chooses for purposes of financial statements and audits.

*Date of completion* means the date on which all work under an award is completed or the date on the award document, or any supplement or amendment thereto, on which HHS awarding agency sponsorship ends.

*Departmental Appeals Board* means the independent office established in the Office of the Secretary with delegated authority from the Secretary to review and decide certain disputes between recipients of HHS funds and HHS awarding agencies under 45 CFR part 16 and to perform other review, adjudication and mediation services as assigned.

*Disallowed costs* mean those charges on an award that the HHS awarding agency determines to be unallowable,

in accordance with the applicable Federal cost principles or other terms and conditions contained in the award.

*Discretionary award* means an award made by an HHS awarding agency in keeping with specific statutory authority which enables the agency to exercise judgment ("discretion") in selecting the applicant/recipient organization through a competitive award process.

*Equipment* means tangible nonexpendable personal property, including exempt property, charged directly to the award having a useful life of more than one year and an acquisition cost of \$5000 or more per unit. However, consistent with recipient policy, lower limits may be established.

*Excess property* means property under the control of any HHS awarding agency that, as determined by the head of the awarding agency or his/her delegate, is no longer required for the agency's needs or the discharge of its responsibilities.

*Exempt property* means tangible personal property acquired in whole or in part with Federal funds, where the HHS awarding agency has statutory authority to vest title in the recipient without further obligation to the Federal Government. An example of exempt property authority is contained in the Federal Grant and Cooperative Agreement Act, 31 U.S.C. 6306, for property acquired under an award to conduct basic or applied research by a nonprofit institution of higher education or nonprofit organization whose principal purpose is conducting scientific research.

*Federal funds authorized* mean the total amount of Federal funds obligated by the HHS awarding agency for use by the recipient. This amount may include any authorized carryover of unobligated funds from prior funding periods when permitted by the HHS awarding agency's implementing instructions or authorized by the terms and conditions of the award.

*Federal share* of real property, equipment, or supplies means that percentage of the property's or supplies' acquisition costs and any improvement expenditures paid with Federal funds. This will be the same percentage as the Federal share of the total costs under

the award for the funding period in which the property was acquired (excluding the value of third party in-kind contributions).

*Federally recognized Indian Tribal government* means the governing body of any Indian tribe, band, nation, or other organized group or community (including any Native village as defined in section 3 of the Alaska Native Claims Settlement Act certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs.

*Funding period* means the period of time when Federal funding is available for obligation by the recipient.

*Government* means a State or local government or a federally recognized Indian tribal government.

*HHS* means the U.S. Department of Health and Human Services.

*HHS awarding agency* means any organization component of HHS that is authorized to make and administer awards.

*Intangible property and debt instruments* mean, but are not limited to, trademarks, copyrights, patents and patent applications and such property as loans, notes and other debt instruments, lease agreements, stock and other instruments of property ownership, whether considered tangible or intangible.

*Local government* means a local unit of government, including specifically a county, municipality, city, town, township, local public authority, school district, special district, intra-state district, council of governments (whether or not incorporated as a nonprofit corporation under State law), any other regional or interstate entity, or any agency or instrumentality of local government.

*Obligations* mean the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period.

*OGAM* means the Office of Grants and Acquisition Management, which is an organizational component within the Office of the Secretary, HHS, and reports to the Assistant Secretary for Management and Budget.

*OMB* means the U.S. Office of Management and Budget.

*Outlays or expenditures* mean charges made to the project or program. They may be reported on a cash or accrual basis. For reports prepared on a cash basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense charged, the value of third party in-kind contributions applied and the amount of cash advances and payments made to subrecipients. For reports prepared on an accrual basis, outlays are the sum of cash disbursements for direct charges for goods and services, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received, for services performed by employees, contractors, subrecipients and other payees and other amounts becoming owed under programs for which no current services or performance are required.

*Personal property* means property of any kind except real property. It may be tangible, having physical existence, or intangible, having no physical existence, such as copyrights, patents, or securities.

*Prior approval* means written approval by an authorized HHS official evidencing prior consent.

*Program income* means gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award (see exclusions in §74.24 (e) and (h)). Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights, and interest on loans made with award funds. Interest earned on advances of Federal funds is not program income. Except as otherwise provided in the terms and conditions of the award, program income does not include the receipt of principal on loans, rebates, credits, discounts, etc., or interest earned on any of them. Furthermore, program income

does not include taxes, special assessments, levies, and fines raised by governmental recipients.

*Project costs* means all allowable costs, as set forth in the applicable Federal cost principles (see §74.27), incurred by a recipient and the value of the contributions made by third parties in accomplishing the objectives of the award during the project period.

*Project period* means the period established in the award document during which HHS awarding agency sponsorship begins and ends.

*Property* means, unless otherwise stated, real property, equipment, intangible property and debt instruments.

*Real property* means land, including land improvements, structures and appurtenances thereto, but excludes movable machinery and equipment.

*Recipient* means an organization receiving financial assistance directly from an HHS awarding agency to carry out a project or program. The term includes public and private institutions of higher education, public and private hospitals, commercial organizations, and other quasi-public and private nonprofit organizations such as, but not limited to, community action agencies, research institutes, educational associations, and health centers. The term may include foreign or international organizations (such as agencies of the United Nations) which are recipients, subrecipients, or contractors or subcontractors of recipients or subrecipients at the discretion of the HHS awarding agency. The term does not include government-owned contractor-operated facilities or research centers providing continued support for mission-oriented, large-scale programs that are government-owned or controlled, or are designated as federally-funded research and development centers. For entitlement programs listed at 45 CFR 92.4(a)(3), (a)(7), and (a)(8) “recipient” means the government to which an HHS awarding agency awards funds and which is accountable for the use of the funds provided. The recipient in this case is the entire legal entity even if only a particular component of the entity is designated in the award document.

*Research and development* means all research activities, both basic and applied, and all development activities that are supported at universities, colleges, hospitals, other nonprofit institutions, and commercial organizations. “Research” is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. “Development” is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

*Small awards* means a grant or cooperative agreement not exceeding the small purchase threshold fixed at 41 U.S.C. 403(11) (currently \$25,000).

*State* means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

*Subaward* means an award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes financial assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of “award” in this section.

*Subrecipient* means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided. The term may include foreign or international organizations (such as agencies of the United Nations) at the discretion of the HHS awarding agency.

*Supplies* means all personal property excluding equipment, intangible property, and debt instruments as defined

### § 74.3

in this section, and inventions of a contractor conceived or first actually reduced to practice in the performance of work under a funding agreement ("subject inventions"), as defined in 37 CFR part 401, "Rights to Inventions Made by Nonprofit Organizations and Business Firms Under Government Grants, Contracts, and Cooperative Agreements."

*Suspension* means an action by the HHS awarding agency that temporarily withdraws the agency's financial assistance sponsorship under an award, pending corrective action by the recipient or pending a decision to terminate the award.

Suspension of an award is a separate action from suspension under HHS regulations (45 CFR part 76) implementing E.O.s 12549 and 12689, "Debarment and Suspension."

*Termination* means the cancellation of HHS awarding agency sponsorship, in whole or in part, under an agreement at any time prior to the date of completion. For the entitlement programs listed at 45 CFR 92.4 (a)(3), (a)(7), and (a)(8), "termination" shall have that meaning assigned at 45 CFR 92.3.

*Third party in-kind contributions* means the value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program.

*Unliquidated obligations*, for financial reports prepared on a cash basis, mean the amount of obligations incurred by the recipient that has not been paid. For reports prepared on an accrued expenditure basis, they represent the amount of obligations incurred by the recipient for which an outlay has not been recorded.

*Unobligated balance* means the portion of the funds authorized by the HHS awarding agency that has not been obligated by the recipient and is determined by deducting the cumulative obligations from the cumulative funds authorized.

*Unrecovered indirect cost* means the difference between the amount awarded and the amount which could have been

### 45 CFR Subtitle A (10-1-96 Edition)

awarded under the recipient's approved negotiated indirect cost rate.

*Working capital advance* means a procedure whereby funds are advanced to the recipient to cover its estimated disbursement needs for a given initial period.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

### § 74.3 Effect on other issuances.

This part supersedes all administrative requirements of codified program regulations, program manuals, handbooks and other nonregulatory materials which are inconsistent with the requirements of this part, except to the extent they are required by Federal statute, or authorized in accordance with the deviations provision in § 74.4.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

### § 74.4 Deviations.

(a) After consultation with OMB, the HHS OGAM may grant exceptions to HHS awarding agencies for classes of awards or recipients subject to the requirements of this part when exceptions are not prohibited by statute. However, in the interest of maximum uniformity, exceptions from the requirements of this part shall be permitted only in unusual circumstances. HHS awarding agencies may apply more restrictive requirements to a class of awards or recipients when approved by the OGAM, after consultation with the OMB. HHS awarding agencies may apply less restrictive requirements without approval by the OGAM when making small awards except for those requirements which are statutory. Exceptions on a case-by-case basis may also be made by HHS awarding agencies without seeking prior approval from the OGAM. OGAM will maintain a record of all requests for exceptions from the provisions of this part that have been approved for classes of awards or recipients.

(b) As a matter of Departmental policy, requests for individual case deviations will be considered favorably by HHS and its awarding agencies whenever the deviation will facilitate comprehensive or integrated service delivery, or multiple-source consolidated

awards, unless the deviation would impair the integrity of the program.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

#### **§ 74.5 Subawards.**

(a) Unless inconsistent with statutory requirements, this part (except for § 74.12 and the forms prescribed in § 74.22) shall apply to—

(1) Except for subawards under block grants (45 CFR part 96), all subawards received by institutions of higher education, hospitals, other nonprofit organizations, and commercial organizations from any recipient of an HHS award, including any subawards received from States, local governments, and Indian tribal governments covered by 45 CFR part 92; and

(2) All subawards received from States by any entity, including a government entity, under the entitlement programs identified at 45 CFR part 92, § 92.4 (a), (a)(7), and (a)(8), except that §§ 74.12 and 74.25 of this part shall not apply.

(b) Except as provided in paragraph (a)(2) of this section, when State, local, and Indian Tribal government recipients of HHS awards make subawards to a government entity, they shall apply the regulations at 45 CFR part 92, “Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments,” or State rules, whichever apply, to such awards.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

### **Subpart B—Pre-Award Requirements**

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

#### **§ 74.10 Purpose.**

Sections 74.11 through 74.17 prescribe forms and instructions and other pre-award matters to be used in applying for HHS awards.

#### **§ 74.11 Pre-award policies.**

(a) Use of Grants and Cooperative Agreements, and Contracts. The Federal Grant and Cooperative Agreement Act, 31 U.S.C. 6301-08, governs the use

of grants, cooperative agreements and contracts. A grant or cooperative agreement shall be used only when the principal purpose of a transaction is to accomplish a public purpose of support or stimulation authorized by Federal statute. The statutory criterion for choosing between grants and cooperative agreements is that for the latter, “substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.” Contracts shall be used when the principal purpose is acquisition of property or services for the direct benefit or use of the HHS awarding agency.

(b) HHS awarding agencies shall notify the public of funding priorities for discretionary grant programs, unless funding priorities are established by Federal statute.

#### **§ 74.12 Forms for applying for HHS financial assistance.**

(a) HHS awarding agencies shall comply with the applicable report clearance requirements of 5 CFR part 1320, “Controlling Paperwork Burdens on the Public,” with regard to all forms used in place of or as a supplement to the Standard Form 424 (SF-424) series. However, HHS awarding agencies should use the SF-424 series and its program narrative whenever possible.

(b) Applicants shall use the SF-424 series or those forms and instructions prescribed by the HHS awarding agency. Applicants shall submit the original and two copies of any applications unless additional copies are required pursuant to 5 CFR part 1320.

(c) For Federal programs covered by E.O. 12372, as amended by E.O. 12416, “Intergovernmental Review of Federal Programs,” the applicant shall complete the appropriate sections of the SF-424 (Application for Federal Assistance) indicating whether the application was subject to review by the State Single Point of Contact (SPOC). The name and address of the SPOC for a particular State can be obtained from the HHS awarding agency or the Catalog of Federal Domestic Assistance. The SPOC shall advise the applicant whether the program for which application is made has been selected by that

#### § 74.13

State for review. (See also 45 CFR part 100.)

(d) HHS awarding agencies that do not use the SF-424 form will indicate on the application form they prescribe whether the application is subject to review by the State under E.O. 12372.

(e) This section does not apply to applications for subawards.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

#### § 74.13 Debarment and suspension.

Recipients are subject to the non-procurement debarment and suspension common rule implementing E.O.s 12549 and 12689, "Debarment and Suspension," 45 CFR part 76. This common rule restricts subawards and contracts with certain parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

#### § 74.14 Special award conditions.

(a) The HHS awarding agency may impose additional requirements as needed, without regard to § 74.4, above, if an applicant or recipient:

- (1) Has a history of poor performance;
- (2) Is not financially stable;
- (3) Has a management system that does not meet the standards prescribed in this part;
- (4) Has not conformed to the terms and conditions of a previous award; or
- (5) Is not otherwise responsible.

(b) When it imposes any additional requirements, the HHS awarding agency must notify the recipient in writing as to the following:

- (1) The nature of the additional requirements;
- (2) The reason why the additional requirements are being imposed;
- (3) The nature of the corrective actions needed;
- (4) The time allowed for completing the corrective actions; and
- (5) The method for requesting reconsideration of the additional requirements imposed.

(c) The HHS awarding agency will promptly remove any additional requirements once the conditions that prompted them have been corrected.

#### 45 CFR Subtitle A (10-1-96 Edition)

#### § 74.15 Metric system of measurement.

The Metric Conversion Act, as amended by the Omnibus Trade and Competitiveness Act, 15 U.S.C. 205, declares that the metric system is the preferred measurement system for U.S. trade and commerce. The Act requires each Federal agency to establish a date or dates in consultation with the Secretary of Commerce, when the metric system of measurement will be used in the agency's procurements, grants, and other business-related activities. Metric implementation may take longer where the use of the system is initially impractical or likely to cause significant inefficiencies in the accomplishment of federally-funded activities. HHS awarding agencies will follow the provisions of E.O. 12770, "Metric Usage in Federal Government Programs."

#### § 74.16 Resource Conservation and Recovery Act (RCRA), Section 6002 of Public Law 94-580 (codified at 42 U.S.C. 6962).

Under the Act, any State agency or agency of a political subdivision of a State which is using appropriated Federal funds must comply with section 6002 of the RCRA. This section requires that preference be given in procurement programs to the purchase of specific products containing recycled materials identified in guidelines developed by the Environmental Protection Agency (EPA) (40 CFR parts 247-254). Accordingly, State and local institutions of higher education, hospitals, and other nonprofit organizations that receive direct HHS awards or other Federal funds shall give preference in their procurement programs funded with Federal funds to the purchase of recycled products pursuant to the EPA guidelines.

#### § 74.17 Certifications and representations.

Unless prohibited by statute or codified regulation, each HHS awarding agency is authorized and encouraged to allow recipients to submit certifications and representations required

by statute, executive order, or regulation on an annual basis, if the recipients have ongoing and continuing relationships with the HHS awarding agency. Annual certifications and representations shall be signed by the responsible official(s) with the authority to ensure recipients' compliance with the pertinent requirements.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

### Subpart C—Post-Award Requirements

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

#### FINANCIAL AND PROGRAM MANAGEMENT

#### **§ 74.20 Purpose of financial and program management.**

Sections 74.21 through 74.28 prescribe standards for financial management systems, methods for making payments, and rules for satisfying cost sharing and matching requirements, accounting for program income, budget revision approvals, making audits, determining allowability of cost, and establishing fund availability.

#### **§ 74.21 Standards for financial management systems.**

(a) Recipients shall relate financial data to performance data and develop unit cost information whenever practical. For awards that support research, unit cost information is usually not appropriate.

(b) Recipients' financial management systems shall provide for the following:

(1) Accurate, current and complete disclosure of the financial results of each HHS-sponsored project or program in accordance with the reporting requirements set forth in § 74.52. If the HHS awarding agency requires reporting on an accrual basis from a recipient that maintains its records on other than an accrual basis, the recipient shall not be required to establish an accrual accounting system. These recipients may develop such accrual data for their reports on the basis of an analysis of the documentation on hand.

(2) Records that identify adequately the source and application of funds for HHS-sponsored activities. These

records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(3) Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.

(4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit cost data. (Unit cost data are usually not appropriate for awards that support research.)

(5) Written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes by the recipient. To the extent that the provisions of the Cash Management Improvement Act (CMIA) (Pub. L. 101-453) and its implementing regulations, "Rules and Procedures for Funds Transfers," (31 CFR part 205) apply, payment methods of State agencies, instrumentalities, and fiscal agents shall be consistent with CMIA Treasury-State Agreements, or the CMIA default procedures codified at 31 CFR 205.9(f).

(6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(7) Accounting records, including cost accounting records, that are supported by source documentation.

(c) Where the Federal Government guarantees or insures the repayment of money borrowed by the recipient, the HHS awarding agency, at its discretion, may require adequate bonding and insurance if the bonding and insurance requirements of the recipient are not deemed adequate to protect the interest of the Federal Government.

(d) The HHS awarding agency may require adequate fidelity bond coverage where the recipient lacks sufficient coverage to protect the Federal Government's interest.



## § 74.22

(e) Where bonds are required in the situations described in § 74.21 (c) and (d), the bonds shall be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies Doing Business with the United States."

### § 74.22 Payment.

(a) Unless inconsistent with statutory program purposes, payment methods shall minimize the time elapsing between the transfer of funds from the U.S. Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements, or the CMIA default procedures codified at 31 CFR 205.9, to the extent that either applies.

(b)(1) Recipients will be paid in advance, provided they maintain or demonstrate the willingness to maintain:

(i) Written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient; and

(ii) Financial management systems that meet the standards for fund control and accountability as established in § 74.21.

(2) Unless inconsistent with statutory program purposes, cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.

(c) Whenever possible, advances will be consolidated to cover anticipated cash needs for all awards made by all HHS awarding agencies to the recipient.

(1) Advance payment mechanisms include electronic funds transfer, with Treasury checks available on an exception basis.

## 45 CFR Subtitle A (10–1–96 Edition)

(2) Advance payment mechanisms are subject to 31 CFR part 205.

(3) Recipients may submit requests for advances and reimbursements at least monthly when electronic fund transfers are not used.

(d) Requests for Treasury check advance payment shall be submitted on PMS-270, "Request for Advance or Reimbursement," or other forms as may be authorized by HHS. This form is not to be used when Treasury check advance payments are made to the recipient automatically through the use of a predetermined payment schedule or if precluded by special HHS-wide instructions for electronic funds transfer.

(e) Reimbursement is the preferred method when the requirements in paragraph (b) of this section cannot be met. The HHS awarding agency may also use this method on any construction agreement, or if the major portion of the construction project is accomplished through private market financing or Federal loans, and the HHS assistance constitutes a minor portion of the project.

(1) When the reimbursement method is used, HHS will make payment within 30 days after receipt of the billing, unless the billing is improper.

(2) Recipients may submit a request for reimbursement at least monthly when electronic funds transfers are not used.

(f) If a recipient cannot meet the criteria for advance payments and the HHS awarding agency has determined that reimbursement is not feasible because the recipient lacks sufficient working capital, HHS may provide cash on a working capital advance basis. Under this procedure, HHS advances cash to the recipient to cover its estimated disbursement needs for an initial period generally geared to the recipient's disbursing cycle. Thereafter, HHS reimburses the recipient for its actual cash disbursements. The working capital advance method of payment will not be used for recipients unwilling or unable to provide timely advances to their subrecipient to meet the subrecipient's actual cash disbursements.

(g) Unless inconsistent with statutory program purposes, to the extent available, recipients shall disburse

funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.

(h) Unless otherwise required by statute, the HHS awarding agency will not withhold payments for proper charges made by recipients at any time during the project period unless paragraph (h) (1) or (2) of this section applies:

(1) A recipient has failed to comply with the project objectives, the terms and conditions of the award, or HHS awarding agency reporting requirements.

(2) The recipient or subrecipient is delinquent in a debt to the United States. Under such conditions, the HHS awarding agency may, upon reasonable notice, inform the recipient that payments shall not be made for obligations incurred after a specified date until the conditions are corrected or the indebtedness to the Federal Government is liquidated. (See 45 CFR part 30).

(i) Standards governing the use of banks and other institutions as depositories of funds advanced under awards are as follows.

(1) Except for situations described in paragraph (i)(2) of this section, HHS will not require separate depository accounts for funds provided to a recipient or establish any eligibility requirements for depositories for funds provided to a recipient. However, recipients must be able to account for the receipt, obligation and expenditure of funds.

(2) Advances of Federal funds shall be deposited and maintained in insured accounts whenever possible.

(j) Consistent with the national goal of expanding the opportunities for women-owned and minority-owned business enterprises, recipients are encouraged to use women-owned and minority-owned banks (a bank which is owned at least 50 percent by women or minority group members).

(k) Recipients shall maintain advances of Federal funds in interest bearing accounts, unless one of the following conditions apply:

(1) The recipient receives less than \$120,000 in Federal awards per year.

(2) The best reasonably available interest bearing account would not be expected to earn interest in excess of \$250 per year on Federal cash balances.

(3) The depository would require an average or minimum balance so high that it would not be feasible within the expected Federal and non-Federal cash resources.

(l) For those entities where CMIA and its implementing regulations do not apply (see 31 CFR part 205), interest earned on Federal advances deposited in interest bearing accounts shall be remitted annually to the Department of Health and Human Services, Payment Management System, P.O. Box 6021, Rockville, MD 20852. Recipients with Electronic Funds Transfer capability should use an electronic medium such as the FEDWIRE Deposit System. Interest amounts up to \$250 per year may be retained by the recipient for administrative expense. State universities and hospitals shall comply with CMIA, as it pertains to interest. If an entity subject to CMIA uses its own funds to pay pre-award costs for discretionary awards without prior written approval from the HHS awarding agency, it waives its right to recover the interest under CMIA. (See § 74.25(d)).

(m) *PMS-270, Request for Advance or Reimbursement*. Recipients shall use the PMS-270 to request advances or reimbursement for all programs when electronic funds transfer or predetermined advance methods are not used. HHS shall not require recipients to submit more than an original and two copies.

(n) Recipients and subrecipients are not required to use forms PMS-270 and 272 in connection with subaward payments.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

#### **§ 74.23 Cost sharing or matching.**

(a) To be accepted, all cost sharing or matching contributions, including cash and third party in-kind, shall meet all of the following criteria:

(1) Are verifiable from the recipient's records;

(2) Are not included as contributions for any other federally-assisted project or program;

(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives;

(4) Are allowable under the applicable cost principles;

(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching;

(6) Are provided for in the approved budget; and

(7) Conform to other provisions of this part, as applicable.

(b) Unrecovered indirect costs may be included as part of cost sharing or matching.

(c) Values for recipient contributions of services and property shall be established in accordance with the applicable cost principles. If the HHS awarding agency authorizes recipients to donate buildings or land for construction/facilities acquisition projects or long-term use, the value of the donated property for cost sharing or matching shall be the lesser of:

(1) The certified value of the remaining life of the property recorded in the recipient's accounting records at the time of donation; or

(2) The current fair market value. However, when there is sufficient justification, the HHS awarding agency may approve the use of the current fair market value of the donated property, even if it exceeds the certified value at the time of donation to the project.

(d) Volunteer services furnished by professional and technical personnel, consultants, and other skilled and unskilled labor may be counted as cost sharing or matching if the service is an integral and necessary part of an approved project or program. Rates for volunteer services shall be consistent with those paid for similar work in the recipient's organization. In those instances in which the required skills are not found in the recipient's organization, rates shall be consistent with those paid for similar work in the labor market in which the recipient competes for the kind of services involved. In either case, fringe benefits consistent with those paid that are reasonable, allowable, and allocable may be included in the valuation.

(e) When an employer other than the recipient furnishes the services of an

employee, these services shall be valued at the employee's regular rate of pay (plus an amount of fringe benefits that are reasonable, allowable, and allocable, but exclusive of overhead costs), provided these services are in the same skill for which the employee is normally paid.

(f) Donated supplies may include such items as expendable property, office supplies, laboratory supplies or workshop and classroom supplies. Value assessed to donated supplies included in the cost sharing or matching share shall be reasonable and shall not exceed the fair market value of the property at the time of the donation.

(g) The method used for determining cost sharing or matching for donated equipment, buildings and land for which title passes to the recipient may differ according to the purpose of the award, if paragraph (g)(1) or (2) of this section applies:

(1) If the purpose of the award is to assist the recipient in the acquisition of equipment, buildings or land, the total value of the donated property may be claimed as cost sharing or matching.

(2) If the purpose of the award is to support activities that require the use of equipment, buildings or land, normally only depreciation or use charges for equipment and buildings may be made. However, the full value of equipment or other capital assets and fair rental charges for land may be allowed, provided that the HHS awarding agency has approved the charges.

(h) The value of donated property shall be determined in accordance with the usual accounting policies of the recipient, with the following qualifications.

(1) The value of donated land and buildings shall not exceed its fair market value at the time of donation to the recipient as established by an independent appraiser (e.g., certified real property appraiser or General Services Administration representative) and certified by a responsible official of the recipient.

(2) The value of donated equipment shall not exceed the fair market value of equipment of the same age and condition at the time of donation.

(3) The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately-owned building in the same locality.

(4) The value of loaned equipment shall not exceed its fair rental value.

(i) The following requirements pertain to the recipient's supporting records for in-kind contributions from third parties.

(1) Volunteer services shall be documented and, to the extent feasible, supported by the same methods used by the recipient for its own employees, including time records.

(2) The basis for determining the valuation for personal service, material, equipment, buildings and land shall be documented.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

#### § 74.24 Program income.

(a) The standards set forth in this section shall be used to account for program income related to projects financed in whole or in part with Federal funds.

(b) Except as provided below in paragraph (h) of this section, program income earned during the project period shall be retained by the recipient and, in accordance with the terms and conditions of the award, shall be used in one or more of the following ways:

(1) Added to funds committed to the project or program, and used to further eligible project or program objectives;

(2) Used to finance the non-Federal share of the project or program; or

(3) Deducted from the total project or program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

(c) When the HHS awarding agency authorizes the disposition of program income as described in paragraph (b)(1) or (b)(2) of this section, program income in excess of any limits stipulated shall be used in accordance with paragraph (b)(3) of this section.

(d) In the event that the HHS awarding agency does not specify in the terms and conditions of the award how program income is to be used, paragraph (b)(3) of this section shall apply automatically to all projects or pro-

grams except research. For awards that support performance of research work, paragraph (b)(1) of this section shall apply automatically unless:

(1) The HHS awarding agency indicates in the terms and conditions of the award another alternative; or

(2) The recipient is subject to special award conditions under § 74.14; or

(3) The recipient is a commercial organization (see § 74.82).

(e) Unless the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period.

(f) Costs incident to the generation of program income may be deducted from gross income to determine program income, provided these costs have not been charged to the award.

(g) Proceeds from the sale of property shall be handled in accordance with the requirements of the Property Standards. (See §§ 74.30 through 74.37, below).

(h) The Patent and Trademark Laws Amendments, 35 U.S.C. section 200-212, apply to inventions made under an award for performance of experimental, developmental, or research work. Unless the terms and conditions for the award provide otherwise, recipients shall have no obligation to HHS with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions made under an award. However, no scholarship, fellowship, training grant, or other funding agreement made primarily to a recipient for educational purposes will contain any provision giving the Federal agency rights to inventions made by the recipient.

#### § 74.25 Revision of budget and program plans.

(a) The budget plan is the financial expression of the project or program as approved during the award process. It may include either the sum of the Federal and non-Federal shares, or only the Federal share, depending upon HHS awarding agency requirements. It shall be related to performance for program evaluation purposes whenever appropriate.

## § 74.25

(b) Recipients are required to report deviations from budget and program plans, and request prior approvals for budget and program plan revisions, in accordance with this section. Except as provided at §§ 74.4, 74.14, and this section, HHS awarding agencies may not impose other prior approval requirements for specific items.

(c) For nonconstruction awards, recipients shall obtain prior approvals from the HHS awarding agency for one or more of the following program or budget related reasons.

(1) Change in the scope or the objective of the project or program (even if there is no associated budget revision requiring prior written approval).

(2) Change in the project director or principal investigator or other key persons specified in the application or award document.

(3) The absence for more than three months, or a 25 percent reduction in time devoted to the project, by the approved project director or principal investigator.

(4) The need for additional Federal funding.

(5) The inclusion, unless waived by the HHS awarding agency, of costs that require prior approval in accordance with OMB Circular A-21, "Cost Principles for Educational Institutions;" OMB Circular A-122, "Cost Principles for Nonprofit Organizations;" or appendix E of this part, "Principles for Determining Costs Applicable to Research and Development under Grants and Contracts with Hospitals," or 48 CFR part 31, "Contract Cost Principles and Procedures," as applicable.

(6) The transfer of funds allotted for training allowances (direct payment to trainees) to other categories of expense.

(7) Unless described in the application and funded in the approved award, the subaward, transfer or contracting out of any work under an award. This provision does not apply to the purchase of supplies, material, equipment or general support services.

(8) The inclusion of research patient care costs in research awards made for the performance of research work.

(d) Except for requirements listed in paragraphs (c)(1) and (c)(4) of this section, the HHS awarding agency is au-

## 45 CFR Subtitle A (10-1-96 Edition)

thorized, at its option, to waive cost-related and administrative prior written approvals required by this part and its appendixes. Additional waivers may be granted authorizing recipients to do any one or more of the following:

(1) Incur pre-award costs up to 90 calendar days prior to award, or more than 90 calendar days with the prior approval of the HHS awarding agency. However, all pre-award costs are incurred at the recipient's risk: the HHS awarding agency is under no obligation to reimburse such costs if for any reason the applicant does not receive an award or if the award to the recipient is less than anticipated and inadequate to cover such costs.

(2) Initiate a one-time extension of the expiration date of the award of up to 12 months unless one or more of the conditions identified at paragraphs (d)(2)(i), (ii), and (iii) of this section apply. For one-time extensions, the recipient must notify the HHS awarding agency in writing, with the supporting reasons and revised expiration date, at least 10 days before the date specified in the award. This one-time extension may not be exercised either by recipients or HHS awarding agencies merely for the purpose of using unobligated balances. Such extensions are not permitted where:

(i) The terms and conditions of award prohibit the extension; or

(ii) The extension requires additional Federal funds; or

(iii) The extension involves any change in the approved objectives or scope of the project.

(3) Carry forward unobligated balances to subsequent funding periods.

(4) For awards that support performance of research work, unless the HHS awarding agency provides otherwise in the award, or the award is subject to § 74.14 or subpart E of this Part, the prior approval requirements described in paragraphs (d) (1)-(3) of this section are automatically waived (i.e., recipients need not obtain such prior approvals). However, extension of award expiration dates must be approved by the HHS awarding agency if one of the conditions in paragraph (d)(2) of this section applies.

(e) The HHS awarding agencies may not permit any budget changes in a recipient's award that would cause any Federal appropriation to be used for purposes other than those consistent with the original purpose of the authorization and appropriation under which the award was funded.

(f) For construction awards, recipients shall obtain prior written approval promptly from the HHS awarding agency for budget revisions whenever:

(1) The revision results from changes in the scope or the objective of the project or program;

(2) The need arises for additional Federal funds to complete the project; or

(3) A revision is desired which involves specific costs for which prior written approval requirements apply in keeping with the applicable cost principles listed in § 74.27.

(g) When an HHS awarding agency makes an award that provides support for both construction and nonconstruction work, it may require the recipient to obtain prior approval before making any fund or budget transfers between the two types of work supported.

(h) For both construction and nonconstruction awards, recipients shall notify the HHS awarding agency in writing promptly whenever the amount of Federal authorized funds is expected to exceed the needs of the recipient for the project period by more than \$5000 or five percent of the Federal award, whichever is greater. This notification shall not be required if an application for additional funding is submitted for a continuation award.

(i) Within 30 calendar days from the date of receipt of the request for budget revisions, HHS awarding agencies shall notify the recipient whether its requested budget revisions have been approved. If the requested revision is still under consideration at the end of 30 calendar days, the HHS awarding agency must inform the recipient in writing of the date when the recipient may expect a decision.

(j) When requesting approval for budget changes, recipients shall make their requests in writing.

(k) All approvals granted in keeping with the provisions of this section shall

not be valid unless they are in writing, and signed by at least one of the following HHS officials:

(1) The Head of the HHS Operating or Staff Division that made the award or subordinate official with proper delegated authority from the Head, including the Head of the Regional Office of the HHS Operating or Staff Division that made the award; or

(2) The responsible Grants Officer of the HHS Operating or Staff Division that made the award or an individual duly authorized by the Grants Officer.

(l) No other prior approval requirements for specific items may be imposed unless a class deviation has been approved by OMB.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996]

#### § 74.26 Non-Federal audits.

(a)(1) Recipients and subrecipients that are institutions of higher education, hospitals affiliated with institutions of higher education, and other nonprofit organizations shall be subject to the audit requirements contained in OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions." (See Appendix I to this part.)

(2) Recipients and subrecipients that are commercial organizations have two options regarding audits:

(i) A financial related audit (as defined in the Government Auditing Standards, GPO Stock #020-000-00-265—

4) of a particular award in accordance with Government Auditing Standards, in those cases where the recipient receives awards under only one HHS program; or, if awards are received under multiple HHS programs, a financial related audit of all HHS awards in accordance with Government Auditing Standards; or

(ii) An audit that meets the requirements contained in OMB Circular A-133.

(3) Commercial organizations that receive annual HHS awards totaling less than OMB Circular A-133's audit requirement threshold are exempt from requirements for a non-Federal audit for that year, but records must be available for review by appropriate officials of Federal agencies.

(b)(1) OMB Circular A-133 exempts hospitals not affiliated with an institution of higher education. In determining whether this exemption applies, the term *affiliated* includes all situations where:

(i) A hospital or an institution of higher education has an ownership interest in the other entity or some other party (other than a State or local unit of government) has an ownership interest in each of them; or

(ii) An affiliation agreement exists; or

(iii) Federal research or training awards to a hospital or institution of higher education are performed in whole or in part in the facilities of, or involve the staff of, the other entity.

(2) Hospitals not covered by the audit provisions of OMB Circular A-133 are subject to the audit requirements of the HHS awarding agency.

(c) State and local governments shall be subject to the audit requirements contained in the Single Audit Act, 31 U.S.C. 7501–07, and OMB Circular A-128, “Audits of State and Local Governments.” (See appendix J to this part.)

(d)(1) All copies of audit reports required by this section shall be submitted to: Department of Health and Human Services, Office of Inspector General, National External Audit Review Center, Lucas Place, Room 514, 323 West 8th Street, Kansas City, MO 64105.

(2) The HHS Office of Inspector General will distribute copies as appropriate within HHS. Recipients, therefore, are not required to send their audit reports to any other HHS officials. Recipients shall provide their Employer Identification Numbers (EIN) on the cover page of reports and submit along with the printed reports a computer disk containing the entire contents of the audit report or at least the information in the report relating to HHS awards.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11746, Mar. 22, 1996; 61 FR 15564, Apr. 8, 1996]

#### § 74.27 Allowable costs.

(a) For each kind of recipient, there is a particular set of Federal principles that applies in determining allowable costs. Allowability of costs shall be de-

termined in accordance with the cost principles applicable to the entity incurring the costs. Thus, allowability of costs incurred by State, local or federally-recognized Indian tribal governments is determined in accordance with the provisions of OMB Circular A-87, “Cost Principles for State and Local Governments.” The allowability of costs incurred by nonprofit organizations (except for those listed in Attachment C of Circular A-122) is determined in accordance with the provisions of OMB Circular A-122, “Cost Principles for Nonprofit Organizations” and paragraph (b) of this section. The allowability of costs incurred by institutions of higher education is determined in accordance with the provisions of OMB Circular A-21, “Cost Principles for Educational Institutions.” The allowability of costs incurred by hospitals is determined in accordance with the provisions of appendix E of this part, “Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts with Hospitals.” The allowability of costs incurred by commercial organizations and those nonprofit organizations listed in Attachment C to Circular A-122 is determined in accordance with the provisions of the Federal Acquisition Regulation (FAR) at 48 CFR part 31, except that independent research and development costs are unallowable.

(b) OMB Circular A-122 does not cover the treatment of bid and proposal costs or independent research and development costs. The following rules apply to these costs for nonprofit organizations subject to that Circular.

(1) *Bid and proposal costs.* Bid and proposal costs are the immediate costs of preparing bids, proposals, and applications for Federal and non-Federal awards, contracts, and other agreements, including the development of scientific, cost, and other data needed to support the bids, proposals, and applications. Bid and proposal costs of the current accounting period are allowable as indirect costs. Bid and proposal costs of past accounting periods are unallowable in the current period. However, if the recipient's established practice is to treat these costs by some other method, they may be accepted if

they are found to be reasonable and equitable. Bid and proposal costs do not include independent research and development costs covered by paragraph (b)(2) of this section, or pre-award costs covered by OMB Circular A-122, Attachment B, paragraph 33 and § 74.25(d)(1).

(2) *Independent Research and Development costs.* Independent research and development is research and development which is conducted by an organization, and which is not sponsored by Federal or non-Federal awards, contracts, or other agreements. Independent research and development shall be allocated its proportionate share of indirect costs on the same basis as the allocation of indirect costs to sponsored research and development. The cost of independent research and development, including their proportionate share of indirect costs, are unallowable.

#### **§ 74.28 Period of availability of funds.**

Where a funding period is specified, a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the HHS awarding agency pursuant to § 74.25(d)(1).

#### **PROPERTY STANDARDS**

#### **§ 74.30 Purpose of property standards.**

Sections 74.31 through 74.37 set forth uniform standards governing management and disposition of property furnished by HHS or whose cost was charged directly to a project supported by an HHS award. The HHS awarding agency may not impose additional requirements, unless specifically required to do so by Federal statute. The recipient may use its own property management standards and procedures provided they meet the provisions of §§ 74.31 through 74.37.

#### **§ 74.31 Insurance coverage.**

Recipients shall, at a minimum, provide the equivalent insurance coverage for real property and equipment acquired with HHS funds as provided to other property owned by the recipient.

#### **§ 74.32 Real property.**

(a) Title to real property shall vest in the recipient subject to the condition that the recipient shall use the real property for the authorized purpose of the project as long as it is needed and shall not encumber the property without approval of the HHS awarding agency.

(b) The recipient shall obtain written approval from the HHS awarding agency for the use of real property in other federally-sponsored projects when the recipient determines that the property is no longer needed for the purpose of the original project. Use in other projects shall be limited to those under federally-sponsored projects (i.e., awards) or programs that have purposes consistent with those authorized for support by the HHS awarding agency.

(c) When the real property is no longer needed as provided in paragraphs (a) and (b) of this section, the recipient shall request disposition instructions from the HHS awarding agency or its successor. The HHS awarding agency must provide one or more of the following disposition instructions:

(1) The recipient may be permitted to retain title without further obligation to the Federal Government after it compensates the Federal Government for that percentage of the current fair market value of the property attributable to the Federal share in the project.

(2) The recipient may be directed to sell the property under guidelines provided by the HHS awarding agency and pay the Federal Government for that percentage of the current fair market value of the property attributable to the Federal share in the project (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). When the recipient is authorized or required to sell the property, proper sales procedures shall be established that provide for competition to the extent practicable and result in the highest possible return.

(3) The recipient may be directed to transfer title to the property to the Federal Government or to an eligible third party provided that, in such cases, the recipient shall be entitled to



#### § 74.33

compensation for its attributable percentage of the current fair market value of the property.

#### **§ 74.33 Federally-owned and exempt property.**

(a)(1) Title of federally-owned property remains vested in the Federal Government. Recipients shall submit annually an inventory listing of federally-owned property in their custody to the HHS awarding agency. Upon completion of the award or when the property is no longer needed, the recipient shall report the property to the HHS awarding agency for further agency utilization.

(2) If the HHS awarding agency has no further need for the property, it shall be declared excess and reported to the General Services Administration, unless the HHS awarding agency has statutory authority to dispose of the property by alternative methods (e.g., the authority provided by the Federal Technology Transfer Act, 15 U.S.C. 3710(I), to donate research equipment to educational and nonprofit organizations in accordance with E.O. 12821, "Improving Mathematics and Science Education in Support of the National Education Goals"). Appropriate instructions shall be issued to the recipient by the HHS awarding agency.

(b) For research awards to certain types of recipients, 31 U.S.C. 6306 authorizes HHS to vest title to property acquired with Federal funds in the recipient without further obligation to the Federal government and under conditions that HHS considers appropriate. Such property is "exempt property". Exempt property shall not be subject to the requirements of § 74.34, except that it shall be subject to paragraphs (h)(1), (2), and (4) of that section concerning the HHS awarding agency's right to require transfer.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

#### **§ 74.34 Equipment.**

(a) Title to equipment acquired by a recipient with HHS funds shall vest in the recipient, subject to the conditions of this section.

(b)(1) The recipient shall not use equipment acquired with HHS funds to provide services to non-Federal organi-

#### 45 CFR Subtitle A (10-1-96 Edition)

zations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute, for so long as the Federal Government retains an interest in the equipment.

(2) If the equipment is owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by the HHS awarding agency.

(3) User charges shall be treated as program income, in keeping with the provisions of § 74.24.

(c) The recipient shall use the equipment in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds and shall not encumber the property without approval of the HHS awarding agency. When no longer needed for the original project or program, the recipient shall use the equipment in connection with its other federally-sponsored activities, if any, in the following order of priority:

(1) Programs, projects, or activities sponsored by the HHS awarding agency;

(2) Programs, projects, or activities sponsored by other HHS awarding agencies; then

(3) Programs, project, or activities sponsored by other Federal agencies.

(d) During the time that equipment is used on the program, project, or activity for which it was acquired, the recipient shall make it available for use on other projects or programs if such other use will not interfere with the work on the program, project, or activity for which the equipment was originally acquired. First preference for such other use shall be given to other programs, projects, or activities sponsored by the HHS awarding agency. Second preference shall be given to programs, projects, or activities sponsored by other HHS awarding agencies. Third preference shall be given to programs, projects, or activities sponsored by other Federal agencies.

(e) When acquiring replacement equipment, the recipient may use the equipment to be replaced as trade-in or

sell the equipment and use the proceeds to offset the costs of the replacement equipment subject to the approval of the HHS awarding agency.

(f) The recipient's property management standards for equipment acquired with Federal funds and federally-owned equipment shall include all of the following:

(1) Equipment records shall be maintained accurately and shall include the following information:

- (i) A description of the equipment;
- (ii) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number;
- (iii) Source of the equipment, including the award number;
- (iv) Whether title vests in the recipient or the Federal Government;
- (v) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost;
- (vi) Information from which one can calculate the percentage of HHS's share in the cost of the equipment (not applicable to equipment furnished by the Federal Government);
- (vii) Location and condition of the equipment and the date the information was reported;
- (viii) Unit acquisition cost; and
- (ix) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates the HHS awarding agency for its share.

(2) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(3) The recipient shall take a physical inventory of equipment and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(4) recipient shall maintain a control system to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft

of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify the HHS awarding agency.

(5) The recipient shall implement adequate maintenance procedures to keep the equipment in good condition.

(6) Where the recipient is authorized or required to sell the equipment, proper sales procedures shall be established which provide for competition to the extent practicable and result in the highest possible return.

(g) When the recipient no longer needs the equipment, it may use the equipment for other activities in accordance with the following standards. For equipment with a current per unit fair market value of \$5000 or more, the recipient may retain the equipment for other uses provided that compensation is made to the original HHS awarding agency or its successor. The amount of compensation shall be computed by applying the percentage of HHS's share in the cost of the original project or program to the current fair market value of the equipment. If the recipient has no need for the equipment, the recipient shall request disposition instructions from the HHS awarding agency; such instructions must be issued to the recipient no later than 120 calendar days after the recipient's request and the following procedures shall govern:

(1) If so instructed or if disposition instructions are not issued within 120 calendar days after the recipient's request, the recipient shall sell the equipment and reimburse the HHS awarding agency an amount computed by applying to the sales proceeds the percentage of HHS share in the cost of the original project or program. However, the recipient shall be permitted to deduct and retain from the HHS share \$500 or ten percent of the proceeds, whichever is less, for the recipient's selling and handling expenses.

(2) If the recipient is instructed to ship the equipment elsewhere, the recipient shall be reimbursed by the HHS awarding agency by an amount which is computed by applying the percentage of the recipient's share in the cost of the original project or program to the current fair market value of the

#### § 74.35

equipment, plus any reasonable shipping or interim storage costs incurred.

(3) If the recipient is instructed to otherwise dispose of the equipment, the recipient will be reimbursed by the HHS awarding agency for such costs incurred in its disposition.

(4) If the recipient's project or program for which or under which the equipment was acquired is still receiving support from the same HHS program, and if the HHS awarding agency approves, the net amount due may be used for allowable costs of that project or program. Otherwise the net amount must be remitted to the HHS awarding agency by check.

(h) The HHS awarding agency reserves the right to order the transfer of title to the Federal Government or to a third party named by the awarding agency when such third party is otherwise eligible under existing statutes. Such transfer shall be subject to the following standards:

(1) The equipment shall be appropriately identified in the award or otherwise made known to the recipient in writing.

(2) The HHS awarding agency may require submission of a final inventory that lists all equipment acquired with HHS funds and federally-owned equipment.

(3) If the HHS awarding agency fails to issue disposition instructions within 120 calendar days after receipt of the inventory, the recipient shall apply the standards of paragraph (g)(1) of this section as appropriate.

(4) When the HHS awarding agency exercises its right to order the transfer of title to the Federal Government, the equipment shall be subject to the rules for federally-owned equipment. (See § 74.34(g)).

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

#### § 74.35 Supplies.

(a) Title to supplies shall vest in the recipient upon acquisition. If there is a residual inventory of unused supplies exceeding \$5000 in total aggregate value upon termination or completion of the project or program and the supplies are not needed for any other federally-sponsored project or program, the recipient shall retain the supplies

#### 45 CFR Subtitle A (10-1-96 Edition)

for use on non-federally sponsored activities or sell them, but shall, in either case, compensate the Federal Government for its share. The amount of compensation shall be computed in the same manner as for equipment. (See § 74.34(g)).

(b)(1) The recipient shall not use supplies acquired with Federal funds to provide services to non-Federal organizations for a fee that is less than private companies charge for equivalent services, unless specifically authorized by Federal statute as long as the Federal Government retains an interest in the supplies.

(2) If the supplies are owned by the Federal Government, use on other activities not sponsored by the Federal Government shall be permissible if authorized by the HHS awarding agency.

(3) User charges shall be treated as program income, in keeping with the provisions of § 74.24.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

#### § 74.36 Intangible property.

(a) The recipient may copyright any work that is subject to copyright and was developed, or for which ownership was purchased, under an award. The HHS awarding agency reserves a royalty-free, nonexclusive and irrevocable right to reproduce, publish, or otherwise use the work for Federal purposes, and to authorize others to do so.

(b) Recipients are subject to applicable regulations governing patents and inventions, including government-wide regulations issued by the Department of Commerce at 37 CFR part 401, "Rights to Inventions Made by Non-profit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements."

(c) The Federal Government has the right to:

(1) Obtain, reproduce, publish or otherwise use the data first produced under an award; and

(2) Authorize others to receive, reproduce, publish, or otherwise use such data for Federal purposes.

(d) Title to intangible property and debt instruments purchased or otherwise acquired under an award or subaward vests upon acquisition in the

recipient. The recipient shall use that property for the originally—authorized purpose, and the recipient shall not encumber the property without approval of the HHS awarding agency. When no longer needed for the originally authorized purpose, disposition of the intangible property shall occur in accordance with the provisions of § 74.34 (g) and (h).

#### **§ 74.37 Property trust relationship.**

Real property, equipment, intangible property and debt instruments that are acquired or improved with Federal funds shall be held in trust by the recipients as trustee for the beneficiaries of the project or program under which the property was acquired or improved, and shall not be encumbered without the approval of the HHS awarding agency. Recipients shall record liens or other appropriate notices of record to indicate that real property has been acquired or constructed or, where applicable, improved with Federal funds, and that use and disposition conditions apply to the property.

### **PROCUREMENT STANDARDS**

#### **§ 74.40 Purpose of procurement standards.**

Sections 74.41 through 74.48 set forth standards for use by recipients in establishing procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. These standards are established to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. The standards apply where the cost of the procurement is treated as a direct cost of an award.

#### **§ 74.41 Recipient responsibilities.**

The standards contained in this section do not relieve the recipients of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to the HHS awarding agency, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or

other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

#### **§ 74.42 Codes of conduct.**

The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, or any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employers, or agents of the recipients.

#### **§ 74.43 Competition.**

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft grant applications, or contract specifications, requirements, statements of work, invitations for bids and/

or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

**§ 74.44 Procurement procedures.**

(a) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

(1) Recipients avoid purchasing unnecessary items;

(2) Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the recipient and the Federal Government; and

(3) Solicitations for goods and services provide for all of the following:

(i) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.

(ii) Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids or proposals.

(iii) A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

(iv) The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

(v) The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

(vi) Preference, to the extent practicable and economically feasible, for products and services that conserve

natural resources and protect the environment and are energy efficient.

(b) Positive efforts shall be made by recipients to utilize small businesses, minority-owned firms, and women's business enterprises, whenever possible. Recipients of HHS awards shall take all of the following steps to further this goal.

(1) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

(2) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.

(3) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.

(4) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.

(5) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms and women's business enterprises.

(c) The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods of contracting shall not be used.

(d) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of the proposed procurement. Consideration shall be given to such matters as contractor integrity, record

of past performance, financial and technical resources or accessibility to other necessary resources. In certain circumstances, contracts with certain parties are restricted by agencies' implementation of E.O.s 12549 and 12689, "Debarment and Suspension." (See 45 CFR part 76.)

(e) Recipients shall, on request, make available for the HHS awarding agency, pre-award review and procurement documents, such as request for proposals or invitations for bids, independent cost estimates, etc., when any of the following conditions apply.

(1) A recipient's procurement procedures or operation fails to comply with the procurement standards in this Part.

(2) The procurement is expected to exceed the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently \$100,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

(3) The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

(4) The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement.

(5) A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

#### **§ 74.45 Cost and price analysis.**

Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

#### **§ 74.46 Procurement records.**

Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum: (a) Basis for contractor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price.

#### **§ 74.47 Contract administration.**

A system for contract administration shall be maintained to ensure contractor conformance with the terms, conditions and specifications of the contract and to ensure adequate and timely follow up of all purchases. Recipients shall evaluate contractor performance and document, as appropriate, whether contractors have met the terms, conditions and specifications of the contract.

#### **§ 74.48 Contract provisions.**

The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. The following provisions shall also be applied to subcontracts:

(a) Contracts in excess of the small purchase threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.

(b) All contracts in excess of the simplified acquisition threshold (currently \$100,000) shall contain suitable provisions for termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

(c) Except as otherwise required by statute, an award that requires the contracting (or subcontracting) for construction or facility improvements shall provide for the recipient to follow its own requirements relating to bid guarantees, performance bonds, and

#### § 74.50

payment bonds unless the construction contract or subcontract exceeds \$100,000. For those contracts or subcontracts exceeding \$100,000, the HHS awarding agency may accept the bonding policy and requirements of the recipient, provided the HHS awarding agency has made a determination that the Federal Government's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

(1) A bid guarantee from each bidder equivalent to five percent of the bid price. The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder shall, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(2) A performance bond on the part of the contractor for 100 percent of the contract price. A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

(3) A payment bond on the part of the contractor for 100 percent of the contract price. A "payment bond" is one executed in connection with a contract to assure payment as required by statute of all persons supplying labor and material in the execution of the work provided for in the contract.

(4) Where bonds are required in the situations described herein, the bonds shall be obtained from companies holding certificates of authority as acceptable sureties pursuant to 31 CFR part 223, "Surety Companies Doing Business with the United States."

(d) All negotiated contracts (except those for less than the small purchase threshold) awarded by recipients shall include a provision to the effect that the recipient, the HHS awarding agency, the U.S. Comptroller General, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

(e) All contracts, including small purchases, awarded by recipients and

#### 45 CFR Subtitle A (10-1-96 Edition)

their contractors shall contain the procurement provisions of appendix A to this part, as applicable.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

#### REPORTS AND RECORDS

##### **§ 74.50 Purpose of reports and records.**

Sections 74.51 through 74.53 set forth the procedures for monitoring and reporting on the recipient's financial and program performance and the necessary standard reporting forms. They also set forth record retention requirements.

##### **§ 74.51 Monitoring and reporting program performance.**

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure that subrecipients have met the audit requirements as set forth in § 74.26.

(b) The HHS awarding agency will prescribe the frequency with which the performance reports shall be submitted. Except as provided in paragraph (f) of this section, performance reports will not be required more frequently than quarterly or, less frequently than annually. Annual reports shall be due 90 calendar days after the award year; quarterly or semi-annual reports shall be due 30 days after the reporting period. The HHS awarding agency may require annual reports before the anniversary dates of multiple year awards in lieu of these requirements. The final performance reports are due 90 calendar days after the expiration or termination of the award.

(c) If inappropriate, a final technical or performance report will not be required after completion of the project.

(d) Performance reports shall generally contain, for each award, brief information on each of the following:

(1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.

(2) Reasons why established goals were not met, if appropriate.

(3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

(e) Recipients shall submit the original and two copies of performance reports.

(f) Recipients shall immediately notify the HHS awarding agency of developments that have a significant impact on the award-supported activities. Also, notification shall be given in the case of problems, delays, or adverse conditions which materially impair the ability to meet the objectives of the award. This notification shall include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.

(g) HHS may make site visits, as needed.

(h) The HHS awarding agency complies with the applicable report clearance requirements of 5 CFR part 1320, "Controlling Paperwork Burdens on the Public," when requesting performance data from recipients.

#### **§ 74.52 Financial reporting.**

(a) The following forms are used for obtaining financial information from recipients:

(1) SF-269 or SF-269A, Financial Status Report.

(i) The HHS awarding agency will require recipients to use either the SF-269 (long form) or SF-269A to report the status of funds for all nonconstruction projects or programs. The SF-269 shall always be used if income has been earned. The awarding agency may, however, waive the SF-269 or SF-269A requirement when the PMS-270, Request for Advance or Reimbursement, or PMS-272, Report of Federal Cash Transactions, will provide adequate information to meet its needs, except that a final SF-269 or SF-269A shall be required at the completion of the project when the PMS-270 is used only for advances.

(ii) If the HHS awarding agency requires accrual information and the recipient's accounting records are not normally kept on the accrual basis, the recipient shall not be required to convert its accounting system, but shall

develop such accrual information through best estimates based on an analysis of the documentation on hand.

(iii) The HHS awarding agency will determine the frequency of the Financial Status Report for each project or program, considering the size and complexity of the particular project or program. However, the report will not be required more frequently than quarterly or less frequently than annually except under § 74.14. A final report shall be required at the completion of the agreement.

(iv) Recipients shall submit the SF-269 and SF-269A (an original and two copies) no later than 30 days after the end of each specified reporting period for quarterly and semi-annual reports, and 90 calendar days for annual and final reports. Extensions of reporting due dates may be approved by the HHS awarding agency upon request of the recipient.

(2) PMS-272, Report of Federal Cash Transactions.

(i) When funds are advanced to recipients, the HHS awarding agency requires each recipient to submit the PMS-272 and, when necessary, its continuation sheet, PMS-272A through G. The HHS awarding agency uses this report to monitor cash advanced to recipients and to obtain disbursement information for each agreement with the recipients.

(ii) The HHS awarding agency may require forecasts of Federal cash requirements in the "Remarks" section of the report.

(iii) Recipients shall submit the original and two copies of the PMS-272 15 calendar days following the end of each quarter. The HHS awarding agency may require a monthly report from those recipients receiving advances totaling \$1 million or more per year.

(iv) The HHS awarding agency may waive the requirement for submission of the PMS-272 for any one of the following reasons: (A) When monthly advances do not exceed \$25,000 per recipient, provided that such advances are monitored through other forms contained in this section; (B) If, in HHS' opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances; or, (C) When



#### § 74.53

the electronic payment mechanisms provide adequate data.

(b) When the HHS awarding agency needs additional information or more frequent reports, the following shall be observed.

(1) When additional information is needed to comply with legislative requirements, the HHS awarding agency will issue instructions to require recipients to submit that information under the "Remarks" section of the reports.

(2) When HHS determines that a recipient's accounting system does not meet the standards in § 74.21, additional pertinent information to further monitor awards may be obtained, without regard to § 74.4, upon written notice to the recipient until such time as the system is brought up to standard. In obtaining this information, the HHS awarding agencies comply with report clearance requirements of 5 CFR part 1320, "Controlling Paperwork Burdens on the Public."

(3) The HHS awarding agency may accept the identical information from a recipient in machine readable format or computer printouts or electronic outputs in lieu of prescribed formats.

(4) The HHS awarding agency may provide computer or electronic outputs to recipients when such action expedites or contributes to the accuracy of reporting.

#### **§ 74.53 Retention and access requirements for records.**

(a) This section sets forth requirements for record retention and access to records for awards to recipients.

(b) Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report. The only exceptions are the following:

(1) If any litigation, claim, financial management review, or audit is started before the expiration of the 3-year period, the records shall be retained until all litigation, claims or audit findings

#### 45 CFR Subtitle A (10-1-96 Edition)

involving the records have been resolved and final action taken.

(2) Records for real property and equipment acquired with Federal funds shall be retained for 3 years after final disposition.

(3) When records are transferred to or maintained by the HHS awarding agency, the 3-year retention requirement is not applicable to the recipient.

(4) Indirect cost rate proposals, cost allocations plans, etc., as specified in § 74.53(g).

(c) Copies of original records may be substituted for the original records if authorized by the HHS awarding agency.

(d) The HHS awarding agency will request transfer of certain records to its custody from recipients when it determines that the records possess long term retention value. However, in order to avoid duplicate recordkeeping, the HHS awarding agency may make arrangements for recipients to retain any records that are continuously needed for joint use.

(e) HHS awarding agencies, the HHS Inspector General, the U.S. Comptroller General, or any of their duly authorized representatives, have the right of timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the awards, in order to make audits, examinations, excerpts, transcripts and copies of such documents. This right also includes timely and reasonable access to a recipient's personnel for the purpose of interview and discussion related to such documents. The rights of access in this paragraph are not limited to the required retention period, but shall last as long as records are retained.

(f) Unless required by statute, the HHS awarding agency will not place restrictions on recipients that limit public access to the records of recipients that are pertinent to an award, except when the HHS awarding agency can demonstrate that such records shall be kept confidential and would have been exempted from disclosure pursuant to the Freedom of Information Act, 5 U.S.C. 552, if the records had belonged to the HHS awarding agency.

(g) Paragraphs (g)(1) and (g)(2) of this section apply to the following types of

documents, and their supporting records: Indirect cost rate computations or proposals, cost allocation plans, and any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(1) If the recipient submits to the Federal Government or the subrecipient submits to the recipient the proposal, plan, or other computation to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts on the date of such submission.

(2) If the recipient is not required to submit to the Federal Government or the subrecipient is not required to submit to the recipient the proposal, plan, or other computation for negotiation purposes, then the 3-year retention period for the proposal, plan, or other computation and its supporting records starts at the end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.

#### TERMINATION AND ENFORCEMENT

##### **§ 74.60 Purpose of termination and enforcement.**

Sections 74.61 and 74.62 set forth uniform suspension, termination and enforcement procedures.

##### **§ 74.61 Termination.**

(a) Awards may be terminated in whole or in part only if paragraph (a) (1), (2), or (3) of this section applies.

(1) By the HHS awarding agency, if a recipient materially fails to comply with the terms and conditions of an award.

(2) By the HHS awarding agency with the consent of the recipient, in which case the two parties shall agree upon the termination conditions, including the effective date and, in the case of partial termination, the portion to be terminated.

(3) By the recipient upon sending to the HHS awarding agency written notification setting forth the reasons for such termination, the effective date, and, in the case of partial termination, the portion to be terminated. However,

if the HHS awarding agency determines in the case of partial termination that the reduced or modified portion of the award will not accomplish the purposes for which the award was made, it may terminate the award in its entirety.

(b) If costs are allowed under an award, the responsibilities of the recipient referred to in § 74.71(a), including those for property management as applicable, shall be considered in the termination of the award, and provision shall be made for continuing responsibilities of the recipient after termination, as appropriate.

##### **§ 74.62 Enforcement.**

(a) If a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute or regulation, an assurance, an application, or a notice of award, the HHS awarding agency may, in addition to imposing any of the special conditions outlined in § 74.14, take one or more of the following actions, as appropriate in the circumstances:

(1) Temporarily withhold cash payments pending correction of the deficiency by the recipient or more severe enforcement action by the HHS awarding agency.

(2) Disallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.

(3) Wholly or partly suspend or terminate the current award.

(4) Withhold further awards for the project or program.

(5) Take any other remedies that may be legally available.

(b) In taking an enforcement action, the HHS awarding agency will provide the recipient or subrecipient an opportunity for such hearing, appeal, or other administrative proceeding to which the recipient or subrecipient is entitled under any statute or regulation applicable to the action. (See also 45 CFR parts 16, 75, and 95.)

(c) Costs to a recipient resulting from obligations incurred by the recipient during a suspension or after termination of an award are not allowable unless the HHS awarding agency expressly authorizes them in the notice of suspension or termination or subsequently. Other recipient costs during

## § 74.70

suspension or after termination which are necessary and not reasonably avoidable are allowable if:

(1) The costs result from obligations which were properly incurred by the recipient before the effective date of suspension or termination, are not in anticipation of it, and in the case of a termination, are noncancellable; and

(2) The costs would be allowable if the award were not suspended or expired normally at the end of the funding period in which the termination takes effect.

(d) The enforcement remedies identified in this section, including suspension and termination, do not preclude a recipient from being subject to debarment and suspension under E.O.s 12549 and 12689 and the HHS implementing regulations at § 74.13 of this part and 45 CFR part 76.

### Subpart D—After-the-Award Requirements

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

#### § 74.70 Purpose.

Sections 74.71 through 74.73 contain closeout procedures and other procedures for subsequent disallowances and adjustments.

#### § 74.71 Closeout procedures.

(a) Recipients shall submit, within 90 calendar days after the date of completion of the award, all financial, performance, and other reports as required by the terms and conditions of the award. The HHS awarding agency may approve extensions when requested by the recipient.

(b) Unless the HHS awarding agency authorizes an extension, a recipient shall liquidate all obligations incurred under the award not later than 90 calendar days after the funding period or the date of completion as specified in the terms and conditions of the award or in agency implementing instructions.

(c) HHS will make prompt payments to a recipient for allowable reimbursable costs under the award being closed out.

(d) The recipient shall promptly refund any balances of unobligated cash

## 45 CFR Subtitle A (10–1–96 Edition)

that HHS has advanced or paid and that is not authorized to be retained by the recipient for use in other projects. 45 CFR part 30 governs unreturned amounts that become delinquent debts.

(e) When authorized by the terms and conditions of the award, HHS will make a settlement for any upward or downward adjustments to the Federal share of costs after closeout reports are received.

(f) The recipient shall account for any real and personal property acquired with HHS funds or received from the Federal Government in accordance with §§ 74.31 through 74.37.

(g) In the event a final audit has not been performed prior to the closeout of an award, HHS retains the right to recover an appropriate amount after fully considering the recommendations on disallowed costs resulting from the final audit.

#### § 74.72 Subsequent adjustments and continuing responsibilities.

(a) The closeout of an award does not affect any of the following:

(1) The right of the HHS awarding agency to disallow costs and recover funds on the basis of a later audit or other review.

(2) The obligation of the recipient to return any funds due as a result of later refunds, corrections, or other transactions.

(3) Audit requirements in § 74.26.

(4) Property management requirements in §§ 74.31 through 74.37.

(5) Records retention requirements in § 74.53.

(b) After closeout of an award, a relationship created under an award may be modified or ended in whole or in part with the consent of the HHS awarding agency and the recipient, provided the responsibilities of the recipient referred to in § 74.72(a), including those for property management as applicable, are considered and provisions made for continuing responsibilities of the recipient, as appropriate.

#### § 74.73 Collection of amounts due.

(a) Any funds paid to a recipient in excess of the amount to which the recipient is finally determined to be entitled under the terms and conditions of

the award constitute a debt to the Federal Government. If not paid within a reasonable period after the demand for payment, the HHS awarding agency may reduce the debt by paragraph (a) (1), (2), or (3) of this section:

(1) Making an administrative offset against other requests for reimbursements.

(2) Withholding advance payments otherwise due the recipient.

(3) Taking other action permitted by statute.

(b) Except as otherwise provided by law, HHS awarding agencies will charge interest on an overdue debt in accordance with 4 CFR ch. II, "Federal Claims Collection Standards." (See 45 CFR part 30.)

#### **Subpart E—Special Provisions for Awards to Commercial Organizations**

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

##### **§ 74.80 Scope of subpart.**

This subpart contains provisions that apply to awards to commercial organizations. These provisions are in addition to other applicable provisions of this part, or they make exceptions from other provisions of this part for awards to commercial organizations.

##### **§ 74.81 Prohibition against profit.**

Except for awards under the Small Business Innovation Research (SBIR) and Small Business Technology Transfer Research (STTR) programs (15 U.S.C. 638), no HHS funds may be paid as profit to any recipient even if the recipient is a commercial organization. Profit is any amount in excess of allowable direct and indirect costs.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

##### **§ 74.82 Program income.**

The additional costs alternative described in § 74.24(b)(1) may not be applied to program income earned by a commercial organization except in the SBIR and STTR programs.

#### **Subpart F—Disputes**

SOURCE: 59 FR 43760, Aug. 25, 1994, unless otherwise noted.

##### **§ 74.90 Final decisions in disputes.**

(a) HHS attempts to promptly issue final decisions in disputes and in other matters affecting the interests of recipients. However, final decisions adverse to the recipient are not issued until it is clear that the matter cannot be resolved through further exchange of information and views.

(b) Under various HHS statutes or regulations, recipients have the right to appeal from, or to have a hearing on, certain final decisions by HHS awarding agencies. (See, for example, subpart D of 42 CFR part 50, and 45 CFR parts 16 and 75). Paragraphs (c) and (d) of this section set forth the standards HHS expects its member agencies to meet in issuing a final decision covered by any of the statutes or regulations.

(c) The decision may be brief but must contain:

(1) A complete statement of the background and basis of the awarding agency's decision, including reference to the pertinent statutes, regulations, or other governing documents; and

(2) Enough information to enable the recipient to understand the issues and the position of the HHS awarding agency.

(d) The following or similar language (consistent with the terminology of the applicable statutes or regulations) should appear at the end of the decision: "This is the final decision of the (title of grants officer or other official responsible for the decision). It shall be the final decision of the Department unless, within 30 days after receiving this decision, you deliver or mail (you should use registered or certified mail to establish the date) a written notice of appeal to (name and address of appropriate contact, e.g., the office responsible for awarding agency preliminary appeal process or, where none, the Departmental Appeals Board, Department of Health and Human Services, Washington, DC 20201). You shall attach to the notice a copy of this decision, note that you intend an appeal,

## § 74.91

state the amount in dispute, and briefly state why you think that this decision is wrong. You will be notified of further procedures.”

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]

### § 74.91 Alternative dispute resolution.

HHS encourages its awarding agencies and recipients to try to resolve disputes by using alternative dispute resolution (ADR) techniques. ADR often is effective in reducing the cost, delay and contentiousness involved in appeals and other traditional ways of handling disputes. ADR techniques include mediation, neutral evaluation and other consensual methods. Information about ADR is available from the HHS Dispute Resolution Specialist at the Departmental Appeals Board, U.S. Department of Health and Human Services, Washington, DC 20201.

#### APPENDIX A TO PART 74—CONTRACT PROVISIONS

All contracts awarded by a recipient, including small purchases, shall contain the following provisions as applicable where the cost of the contract is treated as a direct cost of an award:

1. *Equal Employment Opportunity*—All contracts shall contain a provision requiring compliance with E.O. 11246, “Equal Employment Opportunity,” as amended by E.O. 11375, “Amending Executive Order 11246 Relating to Equal Employment Opportunity,” and as supplemented by regulations at 41 CFR part 60, “Office of Federal Contract Compliance Programs, Equal Employment Opportunity, Department of Labor.”

2. *Copeland “Anti-Kickback” Act (18 U.S.C. 874 and 40 U.S.C. 276c)*—All contracts and subgrants in excess of \$100,000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland “Anti-Kickback” Act, 18 U.S.C. 874, as supplemented by Department of Labor regulations, 29 CFR part 3, “Contractors and Subcontractors on Public Building or Public Work Financed in Whole or in Part by Loans or Grants from the United States.” The Act provides that each contractor or subrecipient shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal awarding agency.

## 45 CFR Subtitle A (10–1–96 Edition)

3. *Davis-Bacon Act, as amended (40 U.S.C. 276a to a-7)*—When required by Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than \$2000 shall include a provision for compliance with the Davis-Bacon Act, 40 U.S.C. 276a to a-7, and as supplemented by Department of Labor regulations, 29 CFR part 5, “Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction.” Under this Act, contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the HHS awarding agency.

4. *Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333)*—Where applicable, all contracts awarded by recipients in excess of \$100,000 for construction contracts and for other contracts that involve the employment of mechanics or laborers shall include a provision for compliance with sections 102 and 107 of the Contract Work Hours and Safety Standards Act, 40 U.S.C. 327-333, as supplemented by Department of Labor regulations, 29 CFR part 5. Under section 102 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work week of 40 hours. Work in excess of the standard work week is permissible provided that the worker is compensated at a rate of not less than 1½ times the basic rate of pay for all hours worked in excess of 40 hours in the work week. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

5. *Rights to Inventions Made Under a Contract or Agreement*—Contracts or agreements for the performance of experimental, developmental, or research work shall provide for the rights of the Federal Government and the recipient in any resulting invention in accordance with 37 CFR part 401, “Rights to Inventions Made by Nonprofit Organizations and Small Business Firms Under Government Grants, Contracts and Cooperative Agreements,” and any further implementing regulations issued by HHS.

6. *Clean Air Act (42 U.S.C. 7401 et seq.) and the Federal Water Pollution Control Act as amended (33 U.S.C. 1251 et seq.)*—Contracts and subgrants of amounts in excess of \$100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act, 42 U.S.C. 7401 et seq., and the Federal Water Pollution Control Act, as amended 33 U.S.C. 1251 et seq. Violations shall be reported to the HHS and the appropriate Regional Office of the Environmental Protection Agency.

7. *Byrd Anti-Lobbying Amendment (31 U.S.C. 1352)*—Contractors who apply or bid for an award of more than \$100,000 shall file the required certification. Each tier certifies to the tier above that it will not and has not used Federal appropriated funds to pay any person or organization for influencing or attempting to influence an officer or employee of any Federal agency, a member of Congress, officer or employee of Congress, or an employee of a member of Congress in connection with obtaining any Federal contract, grant or any other award covered by 31 U.S.C. 1352. Each tier shall also disclose any lobbying with non-Federal funds that takes place in connection with obtaining any Federal award. Such disclosures are forwarded from tier to tier up to the recipient. (See also 45 CFR part 93).

8. *Debarment and Suspension (E.O.s 12549 and 12689)*—Certain contracts shall not be made to parties listed on the nonprocurement portion of the General Services Administration's "Lists of Parties Excluded from Federal Procurement or Nonprocurement Programs" in accordance with E.O.s 12549 and 12689, "Debarment and Suspension." (See 45 CFR part 76.) This list contains the names of parties debarred, suspended, or otherwise excluded by agencies, and contractors declared ineligible under statutory authority other than E.O. 12549. Contractors with awards that exceed the small purchase threshold shall provide the required certification regarding their exclusion status and that of their principals prior to award.

[59 FR 43760, Aug. 25, 1994, as amended at 61 FR 11747, Mar. 22, 1996]]

#### APPENDIXES B—D TO PART 74 [RESERVED]

#### APPENDIX E TO PART 74—PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO RESEARCH AND DEVELOPMENT UNDER GRANTS AND CONTRACTS WITH HOSPITALS

##### I. PURPOSE AND SCOPE

A. *Objectives.* This appendix provides principles for determining the costs applicable to research and development work performed

by hospitals under grants and contracts with the Department of Health and Human Services. These principles are confined to the subject of cost determination and make no attempt to identify the circumstances or dictate the extent of hospital participation in the financing of a particular research or development project. The principles are designed to provide recognition of the full allocated costs of such research work under generally accepted accounting principles. These principles will be applicable to both proprietary and non-profit hospitals. No provision for profit or other increment above cost is provided for in these principles. However, this is not to be interpreted as precluding a negotiated fee between contracting parties when a fee is appropriate.

B. *Policy guides.* The successful application of these principles requires development of mutual understanding between representatives of hospitals and of the Department of Health and Human Services as to their scope, applicability and interpretation. It is recognized that:

1. The arrangements for hospital participation in the financing of a research and development project are properly subject to negotiation between the agency and the hospital concerned in accordance with such Government-wide criteria as may be applicable.

2. Each hospital, possessing its own unique combination of staff, facilities and experience, should be encouraged to conduct research in a manner consonant with its own institutional philosophies and objectives.

3. Each hospital in the fulfillment of its contractual obligations should be expected to employ sound management practices.

4. The application of the principles established herein shall be in conformance with the generally accepted accounting practices of hospitals.

5. Hospitals receive reimbursements from the Federal Government for differing types of services under various programs such as support of Research and Development (including discrete clinical centers) Health Services Projects, Medicare, etc. It is essential that consistent procedures for determining reimbursable costs for similar services be employed without regard to program differences. Therefore, both the direct and indirect costs of research programs must be identified as a cost center(s) for the cost finding and step-down requirements of the Medicare program, or in its absence the Medicaid program.

C. *Application.* All operating agencies within the Department of Health and Human Services that sponsor research and development work in hospitals will apply these principles and related policy guides in determining the costs incurred for such work under grants and cost-reimbursement type contracts and subcontracts. These principles

will also be used as a guide in the pricing of fixed-price contracts and subcontracts.

## II. DEFINITIONS OF TERMS

A. *Organized research* means all research activities of a hospital that may be identified whether the support for such research is from a federal, non-federal or internal source.

B. *Departmental research* means research activities that are not separately budgeted and accounted for. Such work, which includes all research activities not encompassed under the term organized research, is regarded for purposes of this document as a part of the patient care activities of the hospital.

C. *Research agreement* means any valid arrangement to perform federally-sponsored research or development including grants, cost-reimbursement type contracts, cost-reimbursement type subcontracts, and fixed-price contracts and subcontracts.

D. *Instruction and training* means the formal or informal programs of educating and training technical and professional health services personnel, primarily medical and nursing training. This activity, if separately budgeted or identifiable with specific costs, should be considered as a cost objective for purposes of indirect cost allocations and the development of patient care costs.

E. *Other hospital activities* means all organized activities of a hospital not immediately related to the patient care, research, and instructional and training functions which produce identifiable revenue from the performance of these activities. If a non-related activity does not produce identifiable revenue, it may be necessary to allocate this expense using an appropriate basis. In such a case, the activity may be included as an allocable cost (See paragraph III D below.) Also included under this definition is any category of cost treated as "Unallowable," provided such category of cost identifies a function or activity to which a portion of the institution's indirect cost (as defined in paragraph V. A.) are properly allocable.

F. *Patient care* means those departments or cost centers which render routine or ancillary services to in-patients and/or out-patients. As used in paragraph IX B.23, it means the cost of these services applicable to patients involved in research programs.

G. *Allocation* means the process by which the indirect costs are assigned as between:

1. Organized research,
2. Patient care including departmental research.
3. Instruction and training, and
4. Other hospital activities.

H. *Cost center* means an identifiable department or area (including research) within the hospital which has been assigned an account number in the hospital accounting system

for the purpose of accumulating expense by department or area.

I. *Cost finding* is the process of recasting the data derived from the accounts ordinarily kept by a hospital to ascertain costs of the various types of services rendered. It is the determination of direct costs by specific identification and the proration of indirect costs by allocation.

J. *Step down* is a cost finding method that recognizes that services rendered by certain nonrevenue-producing departments or centers are utilized by certain other nonrevenue producing centers as well as by the revenue-producing centers. All costs of nonrevenue-producing centers are allocated to all centers which they serve, regardless of whether or not these centers produce revenue. Following the apportionment of the cost of the nonrevenue-producing center, that center will be considered closed and no further costs are apportioned to that center.

K. *Scatter bed* is a bed assigned to a research patient based on availability. Research patients occupying these beds are not physically segregated from nonresearch patients occupying beds. Scatter beds are geographically dispersed among all the beds available for use in the hospital. There are no special features attendant to a scatter bed that distinguishes it from others that could just as well have been occupied.

L. *Discrete bed* is a bed or beds that have been set aside for occupancy by research patients and are physically segregated from other hospital beds in an environment that permits an easily ascertainable allocation of costs associated with the space they occupy and the services they generate.

## III. BASIC CONSIDERATIONS

A. *Composition of total costs.* The cost of a research agreement is comprised of the allowable direct costs incident to its performance plus the allocable portion of the allowable indirect costs of the hospital less applicable credits. (See paragraph III-E.)

B. *Factors affecting allowability of costs.* The tests of allowability of costs under these principles are:

1. They must be reasonable.
2. They must be assigned to research agreements under the standards and methods provided herein.
3. They must be accorded consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances (See paragraph I-E.5.) and
4. They must conform to any limitations or exclusions set forth in these principles or in the research agreement as to types or amounts of cost items.

C. *Reasonable costs.* A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefor reflect the action that a

prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made. Major considerations involved in the determination of the reasonableness of a cost are:

1. Whether or not the cost is of a type generally recognized as necessary for the operation of the hospital or the performance of the research agreement,

2. The restraints or requirements imposed by such factors as arm's length bargaining, federal and state laws and regulations, and research agreement terms and conditions,

3. Whether or not the individuals concerned acted with due prudence in the circumstances, considering their responsibilities to the hospital, its patients, its employees, its students, the Government, and the public at large, and

4. The extent to which the actions taken with respect to the incurrence of the cost are consistent with established hospital policies and practices applicable to the work of the hospital generally, including Government research.

*D. Allocable costs.* 1. A cost is allocable to a particular cost center (i.e., a specific function, project, research agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost center in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a research agreement if it is incurred solely to advance the work under the research agreement; or it benefits both the research agreement and other work of the hospital in proportions that can be approximated through use of reasonable methods; or it is necessary to the overall operation of the hospital and, in light of the standards provided in this chapter, is deemed to be assignable in part to organized research. Where the purchase of equipment or other capital items are specifically authorized under a research agreement, the amounts thus authorized for such purchases are allocable to the research agreement regardless of the use that may subsequently be made of the equipment or other capital items involved.

2. Any costs allocable to a particular research agreement under the standards provided in these principles may not be shifted to other research agreements in order to meet deficiencies caused by overruns or other fund considerations, to avoid restrictions imposed by law or by terms of the research agreement, or for other reasons of convenience.

*E. Applicable credits.* 1. The term applicable credits refers to those receipts or negative expenditure types of transactions which operate to offset or reduce expense items that are allocable to research agreements as direct or indirect costs as outlined in paragraph V-A. Typical examples of such transactions are: purchase discounts, rebates, or

allowances; recoveries or indemnities on losses; sales of scrap or incidental services; tuition; adjustments of overpayments or erroneous charges; and services rendered to patients admitted to federally funded clinical research centers, primarily for care though also participating in research protocols.

2. In some instances, the amounts received from the Federal Government to finance hospital activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the hospital in determining the rates or amounts to be charged to government research for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by federal funds. Thus, where such items are provided for or benefit a particular hospital activity, i.e., patient care, research, instruction and training, or other, they should be treated as an offset to the indirect costs apportioned to that activity. Where the benefits are common to all hospital activities they should be treated as a credit to the total indirect cost pool before allocation to the various cost objectives.

#### IV. DIRECT COSTS

*A. General.* Direct costs are those that can be identified specifically with a particular cost center. For this purpose, the term cost center refers not only to the ultimate centers against which costs are finally lodged such as research agreements, but also to other established cost centers such as the individual accounts for recording particular objects or items of expense, and the separate account groupings designed to record the expenses incurred by individual organizational units, functions, projects and the like. In general, the administrative functions and service activities described in paragraph VI are identifiable as separate cost centers, and the expenses associated with such centers become eligible in due course for distribution as indirect costs of research agreements and other ultimate cost centers.

*B. Application to research agreements.* Identifiable benefit to the research work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of research agreements. Typical of transactions chargeable to a research agreement as direct costs are the compensation of employees for the time or effort devoted to the performance of work under the research agreement, including related staff benefit and pension plan costs to the extent that such items are consistently accorded to all employees and treated by the hospital as direct rather than indirect costs (see paragraph V. B4b); the costs of materials consumed or expended in



the performance of such work; and other items of expense incurred for the research agreement, such as extraordinary utility consumption. The cost of materials supplied from stock or services rendered by specialized facilities or other institutional service operations may be included as direct costs of research agreements provided such items are consistently treated by the institution as direct rather than indirect costs and are charged under a recognized method of costing or pricing designed to recover only the actual direct and indirect costs of such material or service and conforming to generally accepted cost accounting practices consistently followed by the institution.

#### V. INDIRECT COSTS

A. *General.* Indirect costs are those that have been incurred for common or joint objectives, and thus are not readily subject to treatment as direct costs of research agreements or other ultimate or revenue producing cost centers. In hospitals such costs normally are classified but not necessarily restricted to the following functional categories: Depreciation; Administrative and General (including fringe benefits if not charged directly); Operation of Plant; Maintenance of Plant; Laundry and Linen Service; Housekeeping; Dietary; Maintenance of Personnel; and Medical Records and Library.

B. *Criteria for distribution*—1. *Base period.* A base period for distribution of indirect costs is the period during which such costs are incurred and accumulated for distribution to work performed within that period. The base period normally should coincide with the fiscal year established by the hospital, but in any event the base period should be so selected as to avoid inequities in the distribution of costs.

2. *Need for cost groupings.* The overall objective of the allocation process is to distribute the indirect costs described in paragraph VI to organized research, patient care, instruction and training, and other hospital activities in reasonable proportions consistent with the nature and extent of the use of the hospital's resources by research personnel, medical staff, patients, students, and other personnel or organizations. In order to achieve this objective with reasonable precision, it may be necessary to provide for selective distribution by establishing separate groupings of cost within one or more of the functional categories of indirect costs referred to in paragraph V-A. In general, the cost groupings established within a functional category should constitute, in each case, a pool of those items of expense that are considered to be of like character in terms of their relative contribution to (or degree of remoteness from) the particular cost centers to which distribution is appropriate. Each such pool or cost grouping

should then be distributed individually to the related cost centers, using the distribution base or method most appropriate in the light of the guides set out in B3 below. While this paragraph places primary emphasis on a step-down method of indirect cost computation, paragraph VIII provides an alternate method which may be used under certain conditions.

3. *Selection of distribution method.* Actual conditions must be taken into account in selecting the method or base to be used in distributing to related cost centers the expenses assembled under each of the individual cost groups established as indicated under B2 above. Where a distribution can be made by assignment of a cost grouping directly to the area benefited, the distribution should be made in that manner. Care should be given, however, to eliminate similar or duplicative costs from any other distribution made to this area. Where the expenses under a cost grouping are more general in nature, the distribution to related cost centers should be made through use of a selected base which will produce results which are equitable to both the Government and the hospital. In general, any cost element or cost-related factor associated with the hospital's work is potentially adaptable for use as a distribution base provided:

a. It can readily be expressed in terms of dollars or other quantitative measure (total direct expenditures, direct salaries, manhours applied, square feet utilized, hours of usage, number of documents processed, population served, and the like); and

b. It is common to the related cost centers during the base period. The essential consideration in selection of the distribution base in each instance is that it be the one best suited for assigning the pool of costs to related cost centers in accord with the relative benefits derived; the traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable.

4. *General consideration on cost groupings.* The extent to which separate cost groupings and selective distribution would be appropriate at a hospital is a matter of judgment to be determined on a case-by-case basis. Typical situations which may warrant the establishment of two or more separate cost groups (based on account classification or analysis) within a functional category include but are not limited to the following:

a. Where certain items or categories of expense relate solely to one of the major divisions of the hospital (patient care, sponsored research, instruction and training, or other hospital activities) or to any two but not all, such expenses should be set aside as a separate cost grouping for direct assignment or selective distribution in accordance with the guides provided in B2 and B3 above.

b. Where any types of expense ordinary treated as indirect cost as outlined in paragraph V-A are charged to research agreements as direct costs, the similar type expenses applicable to other activities of the institution must through separate cost grouping be excluded from the indirect costs allocable to research agreements.

c. Where it is determined that certain expenses are for the support of a service unit or facility whose output is susceptible of measurement on a workload or other quantitative basis, such expenses should be set aside as a separate cost grouping for distribution on such basis to organized research and other hospital activities.

d. Where organized activities (including identifiable segments of organized research as well as the activities cited in paragraph II-E) provide their own purchasing, personnel administration, building maintenance, or housekeeping or similar service, the distribution of such elements of indirect cost to such activities should be accomplished through cost grouping which includes only that portion of central indirect costs (such as for overall management) which are properly allocable to such activities.

e. Where the hospital elects to treat as indirect charges the costs of pension plans and other staff benefits, such costs should be set aside as a separate cost grouping for selective distribution to related cost centers, including organized research.

f. Where the hospital is affiliated with a medical school or some other institution which performs organized research on the hospital's premises, every effort should be made to establish separate cost groupings in the Administrative and General or other applicable category which will reasonably reflect the use of services and facilities by such research. (See also paragraph VII-A.3)

5. *Materiality.* Where it is determined that the use of separate cost groupings and selective distribution are necessary to produce equitable results, the number of such separate cost groupings within a functional category should be held within practical limits, after taking into consideration the materiality of the amounts involved and the degree of precision attainable through less selective methods of distribution.

C. *Administration of limitations on allowances for indirect costs.* 1. Research grants may be subject to laws and/or administrative regulations that limit the allowance for indirect costs under each such grant to a stated percentage of the direct costs allowed. Agencies that sponsor such grants will establish procedures which will assure that:

a. The terms and amount authorized in each case conform with the provisions of paragraphs III, V and IX of these principles as they apply to matters involving the consistent treatment and allowability of individual items of cost; and

b. The amount actually allowed for indirect costs under each such research grant does not exceed the maximum allowable under the limitation or the amount otherwise allowable under these principles, whichever is the smaller.

2. Where the actual allowance for indirect costs on any research grant must be restricted to the smaller of the two alternative amounts referred to in C1 above, such alternative amounts should be determined in accordance with the following guides:

a. The maximum allowable under the limitation should be established by applying the stated percentage to a direct cost base which shall include all items of expenditure authorized by the sponsoring agency for inclusion as part of the total cost for the direct benefit of the work under the grant; and

b. The amount otherwise allowable under these principles should be established by applying the current institutional indirect cost rate to those elements of direct cost which were included in the base on which the rate was computed.

3. When the maximum amount allowable under a statutory limitation or the terms of a research agreement is less than the amount otherwise allocable as indirect costs under these principles, the amount not recoverable as indirect costs under the research agreement involved may not be shifted to other research agreements.

#### VI. IDENTIFICATION AND ASSIGNMENT OF INDIRECT COSTS

A. *Depreciation or use charge.* 1. The expenses under this heading should include depreciation (as defined in paragraph IX-B.9a) on buildings, fixed equipment, and movable equipment, except to the extent purchased through federal funds. Where adequate records for the recording of depreciation are not available, a use charge may be substituted for depreciation (See paragraph IX-B.)

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides set forth in paragraph V-B, on a basis that gives primary emphasis to (a) space utilization with respect to depreciation on buildings and fixed equipment; and (b) specific identification of assets and their use with respect to movable equipment as it relates to patient care, organized research, instruction and training, and other hospital activities. Where such records are not sufficient for the purpose of the foregoing, reasonable estimates will suffice as a means for effecting distribution of the amounts involved.

B. *Administration and general expenses.* 1. The expenses under this heading are those that have been incurred for the administrative offices of the hospital including accounting, personnel, purchasing, information centers, telephone expense, and the like

which do not relate solely to any major division of the institution, i.e., solely to patient care, organized research, instruction and training, or other hospital activities.

2. The expenses included in this category may be allocated on the basis of total expenditures exclusive of capital expenditures, or salaries and wages in situations where the results of the distribution made on this basis are deemed to be equitable both to the Government and the hospital; otherwise the distribution of Administration and General expenses should be made through use of selected bases, applied to separate cost groupings established within this category of expenses in accordance with the guides set out in paragraph V-B.

C. *Operation of plant.* 1. The expenses under this heading are those that have been incurred by a central service organization or at the departmental level for the administration, supervision, and provision of utilities (exclusive of telephone expense) and protective services to the physical plant. They include expenses incurred for such items as power plant operations, general utility costs, elevator operations, protection services, and general parking lots.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in paragraph V-B, on a basis that gives primary emphasis to space utilization. The allocations should be developed as follows:

a. Where actual space and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume or space basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

D. *Maintenance of plant.* 1. The expenses under this heading should include:

a. All salaries and wages pertaining to ordinary repair and maintenance work performed by employees on the payroll of the hospital;

b. All supplies and parts used in the ordinary repairing and maintaining of buildings and general equipment; and

c. Amounts paid to outside concerns for the ordinary repairing and maintaining of buildings and general equipment.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in paragraph V-B, on a basis that gives primary emphasis to space utilization. The allocations and apportionments should be developed as follows:

a. Where actual space and related cost records are available and can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume or space basis of allocation is impractical or inequitable, other basis may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

E. *Laundry and linen.* 1. The expenses under this heading should include:

a. Salaries and wages of laundry department employees, seamstresses, clean linen handlers, linen delivery men, etc.;

b. Supplies used in connection with the laundry operation and all linens purchased; and

c. Amounts paid to outside concerns for purchased laundry and/or linen service.

2. The expense included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V-B, on a basis that gives primary emphasis to actual pounds of linen used. The allocations should be developed as follows:

a. Where actual poundage and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where it can be demonstrated that a poundage basis of allocation is impractical or inequitable other bases may be used provided consideration is given to the use of linen by research personnel and others, including patients.

F. *Housekeeping.* 1. The expenses under this heading should include:

a. All salaries and wages of the department head, foreman, maids, porters, janitors, wall washers, and other housekeeping employees;

b. All supplies used in carrying out the housekeeping functions; and

c. Amounts paid to outside concerns for purchased services such as window washing, insect extermination, etc.

2. The expenses included in this category should be allocated to related cost centers in

a manner consistent with the guides provided in paragraph V-B. on a basis that gives primary emphasis to space actually serviced by the housekeeping department. The allocations and apportionments should be developed as follows:

a. Where actual space serviced and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space serviced and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts of housekeeping expenses involved; or

c. Where it can be demonstrated that the space serviced basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of housekeeping services by research personnel and others, including patients.

G. *Dietary*. 1. These expenses, as used herein, shall mean only the subsidy provided by the hospital to its employees including research personnel through its cafeteria operation. The hospital must be able to demonstrate through the use of proper cost accounting techniques that the cafeteria operates at a loss to the benefit of employees.

2. The reasonable operating loss of a subsidized cafeteria operation should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V-B. on a basis that gives primary emphasis to number of employees.

H. *Maintenance (housing) of personnel*. 1. The expenses under this heading should include:

a. The salaries and wages of matrons, clerks, and other employees engaged in work in nurses' residences and other employees' quarters;

b. All supplies used in connection with the operation of such dormitories; and

c. Payments to outside agencies for the rental of houses, apartments, or rooms used by hospital personnel.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V-B. on a basis that gives primary emphasis to employee utilization of housing facilities. The allocation should be developed as follows:

a. Appropriate credit should be given for all payments received from employees or otherwise to reduce the expense to be allocated;

b. A net cost per housed employee may then be computed; and

c. Allocation should be made on a departmental basis based on the number of housed employees in each respective department.

I. *Medical records and library*. 1. The expenses under this heading should include:

a. The salaries and wages of the records librarian, medical librarian, clerks, stenographers, etc.; and

b. All supplies such as medical record forms, chart covers, filing supplies, stationery, medical library books, periodicals, etc.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in paragraph V-B. on a basis that gives primary emphasis to a special time survey of medical records personnel. If this appears to be impractical or inequitable, other bases may be used provided consideration is given to the use of these facilities by research personnel and others, including patients.

#### VII. DETERMINATION AND APPLICATION OF INDIRECT COST RATE OR RATES

A. *Indirect cost pools*. 1. Subject to (2) below, indirect costs allocated to organized research should be treated as a common pool, and the costs in such common pool should be distributed to individual research agreements benefiting therefrom on a single rate basis.

2. In some instances a single rate basis for use on all government research at a hospital may not be appropriate since it would not take into account those different environmental factors which may affect substantially the indirect costs applicable to a particular segment of government research at the institution. For this purpose, a particular segment of government research may be that performed under a single research agreement or it may consist of research under a group of research agreements performed in a common environment. The environmental factors are not limited to the physical location of the work. Other important factors are the level of the administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. Where a particular segment of government research is performed within an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. An example of this differential may be in the development of a separate indirect cost pool for a clinical research center grant. The separate indirect cost pool should be developed during the course of the regular distribution process, and the separate indirect cost rate resulting therefrom should be utilized provided it is determined that:

a. Such indirect cost rate differs significantly from that which would have obtained under (1) above; and

b. The volume of research work to which such rate would apply is material in relation to other government research at the institution.

3. It is a common practice for grants or contracts awarded to other institutions, typically University Schools of Medicine, to be performed on hospital premises. In these cases the hospital should develop a separate indirect cost pool applicable to the work under such grants or contracts. This pool should be developed by a selective distribution of only those indirect cost categories which benefit the work performed by the other institution, within the practical limits dictated by available data and the materiality of the amounts involved. Hospital costs determined to be allocable to grants or contracts awarded to another institution may not be recovered as a cost of grants or contracts awarded directly to the hospital.

B. *The distribution base.* Preferably, indirect costs allocated to organized research should be distributed to applicable research agreements on the basis of direct salaries and wages. However, where the use of salaries and wages results in an inequitable allocation of costs to the research agreements, total direct costs or a variation thereof, may be used in lieu of salaries and wages. Regardless of the base used, an indirect cost rate should be determined for each of the separate indirect cost pools developed pursuant to paragraph VII-A. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the total direct salaries and wages (or other base selected) for all research agreements identified with such a pool.

C. *Negotiated lump sum for overhead.* A negotiated fixed amount in lieu of indirect costs may be appropriate for self-contained or off-campus research activities where the benefits derived from a hospital's indirect services cannot be readily determined. Such amount negotiated in lieu of indirect costs will be treated as an offset to the appropriate indirect cost pool after allocation to patient care, organized research, instruction and training, and other hospital activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

D. *Predetermined overhead rates.* The utilization of predetermined fixed overhead rates may offer potential advantages in the administration of research agreements by facilitating the preparation of research budgets and permitting more expeditious close out of the agreements when the work is completed. Therefore, to the extent allowed by law, consideration may be given to the negotiation of predetermined fixed rates in those situations where the cost experience and

other pertinent factors available are deemed sufficient to enable the Government and the hospital to reach a reasonable conclusion as to the probable level of the indirect cost rate for the ensuing accounting period.

#### VIII. SIMPLIFIED METHOD FOR SMALL INSTITUTIONS

A. *General.* 1. Where the total direct cost of all government-sponsored research and development work at a hospital in a year is minimal, the use of the abbreviated procedure described in paragraph VIII-B below may be acceptable in the determination of allowable indirect costs. This method may also be used to initially determine a provisional indirect cost rate for hospitals that have not previously established a rate. Under this abbreviated procedure, data taken directly from the institution's most recent annual financial report and immediately available supporting information will be utilized as a basis for determining the indirect cost rate applicable to research agreements at the institution.

2. The rigid formula approach provided under the abbreviated procedure has limitations which may preclude its use at some hospitals either because the minimum data required for this purpose are not readily available or because the application of the abbreviated procedure to the available data produces results which appear inequitable to the Government or the hospital. In any such case, indirect costs should be determined through use of the regular procedure rather than the abbreviated procedure.

3. In certain instances where the total direct cost of all government-sponsored research and development work at the hospital is more than minimal, the abbreviated procedure may be used if prior permission is obtained. This alternative will be granted only in those cases where it can be demonstrated that the step-down technique cannot be followed.

B. *Abbreviated procedure.* 1. Total expenditures as taken from the most recent annual financial report will be adjusted by eliminating from further consideration expenditures for capital items as defined in paragraph IX-B.4 and unallowable costs as defined under various headings in paragraph IX and paragraph III-E.

2. Total expenditures as adjusted under the foregoing will then be distributed among (a) expenditures applicable to administrative and general overhead functions, (b) expenditures applicable to all other overhead functions, and (c) expenditures for all other purposes. The first group shall include amounts associated with the functional categories, Administration and General, and Dietary, as defined in paragraph VI. The second group shall include Depreciation, Operation of Plant, Maintenance of Plant, and Housekeeping. The third group—expenditures for

all other purposes—shall include the amounts applicable to all other activities, namely, patient care, organized research, instruction and training, and other hospital activities as defined under paragraph II-E. For the purposes of this section, the functional categories of Laundry and Linen, Maintenance of Personnel, and Medical Records and Library as defined in paragraph VI shall be considered as expenditures for all other purposes.

3. The expenditures distributed to the first two groups in paragraph VIII-B.2 should then be adjusted by those receipts or negative expenditure types of transactions which tend to reduce expense items allocable to research agreements as indirect costs. Examples of such receipts or negative expenditures are itemized in paragraph III-E.1.

4. In applying the procedures in paragraphs VIII-B.1 and B.2, the cost of unallowable activities such as Gift Shop, Investment Property Management, Fund Raising, and Public Relations, when they benefit from the hospital's indirect cost services, should be treated as expenditures for all other purposes. Such activities are presumed to benefit from the hospital's indirect cost services when they include salaries of personnel working in the hospital. When they do not include such salaries, they should be eliminated from the indirect cost rate computation.

5. The indirect cost rate will then be computed in two stages. The first stage requires the computation of an Administrative and General rate component. This is done by applying a ratio of research direct costs over total direct costs to the Administrative and General pool developed under paragraphs VIII-B.2 and B.3 above. The resultant amount—that which is allocable to research—is divided by the direct research cost base. The second stage requires the computation of an All Other Indirect Cost rate component. This is done by applying a ratio of research direct space over total direct space to All Other Indirect Cost pool developed under paragraphs VIII-B.2 and B.3 above. The resultant amount—that which is allocable to research—is divided by the direct research cost base.

The total of the two rate components will be the institution's indirect cost rate. For the purposes of this section, the research direct cost or space and total direct cost or space will be that cost or space identified with the functional categories classified under Expenditures for all other purposes under paragraph VIII-B.2.

#### IX. GENERAL STANDARDS FOR SELECTED ITEMS OF COST

A. *General.* This section provides standards to be applied in establishing the allowability of certain items involved in determining cost. These standards should apply irrespective of whether a particular item of cost is

properly treated as direct cost or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable; rather, determination as to allowability in each case should be based on the treatment or standards provided for similar or related items of cost. In case of discrepancy between the provisions of a specific research agreement and the applicable standards provided, the provisions of the research agreement should govern. However, in some cases advance understandings should be reached on particular cost items in order that the full costs of research be supported. The extent of allowability of the selected items of cost covered in this section has been stated to apply broadly to many accounting systems in varying environmental situations. Thus, as to any given research agreement, the reasonableness and allocability of certain items of costs may be difficult to determine, particularly in connection with hospitals which have medical school or other affiliations. In order to avoid possible subsequent disallowance or dispute based on unreasonableness or nonallocability, it is important that prospective recipients of federal funds particularly those whose work is predominantly or substantially with the Government, seek agreement with the Government in advance of the incurrence of special or unusual costs in categories where reasonableness or allocability are difficult to determine. Such agreement may also be initiated by the Government. Any such agreement should be incorporated in the research agreement itself. However, the absence of such an advance agreement on any element of cost will not in itself serve to make that element either allowable or unallowable. Examples of costs on which advance agreements may be particularly important are:

1. Facilities costs, such as;
  - a. Depreciation
  - b. Rental
  - c. Use charges for fully depreciated assets
  - d. Idle facilities and idle capacity
  - e. Plant reconversion
  - f. Extraordinary or deferred maintenance and repair
  - g. Acquisition of automatic data processing equipment.
2. Preaward costs
3. Non-hospital professional activities
4. Self-insurance
5. Support services charged directly (computer services, printing and duplicating services, etc.)
6. Employee compensation, travel, and other personnel costs, including;
  - a. Compensation for personal service, including wages and salaries, bonuses and incentives, premium payments, pay for time

not worked, and supplementary compensation and benefits, such as pension and retirement, group insurance, severance pay plans, and other forms of compensation

b. Morale, health, welfare, and food service and dormitory costs

c. Training and education costs

d. Relocation costs, including special or mass personnel movement

B. *Selected items*—1. *Advertising costs.* The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like. The only advertising costs allowable are those which are solely for;

a. The recruitment of persons required for the performance by the institution of obligations arising under the research agreement, when considered in conjunction with all other recruitment costs as set forth in paragraph IX-B.34.

b. The procurement of scarce items for the performance of the research agreement; or

c. The disposal of scrap or surplus materials acquired in the performance of the research agreement.

Costs of this nature, if incurred for more than one research agreement or for both research agreement work and other work of the institution, are allowable to the extent that the principles in paragraphs IV and V are observed.

2. *Bad debts.* Losses arising from uncollectible accounts and other claims and related collection and legal costs are unallowable except that a bad debt may be included as a direct cost of the research agreement to the extent that it is caused by a research patient and approved by the awarding agency. This inclusion is only intended to cover the situation of the patient admitted for research purposes who subsequently or in conjunction with the research receives clinical care for which a charge is made to the patient. If, after exhausting all means of collecting these charges, a bad debt results, it may be considered an appropriate charge to the research agreement.

3. *Bonding costs.* a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the hospital. They arise also in instances where the hospital requires similar assurance.

Included are such types as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the research agreement are allowable.

c. Costs of bonding required by the hospital in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and

the rates and premiums are reasonable under the circumstances.

4. *Capital expenditures.* The costs of equipment, buildings, and repairs which materially increase the value or useful life of buildings or equipment should be capitalized and are unallowable except as provided for in the research agreement.

5. *Civil defense costs.* Civil defense costs are those incurred in planning for, and the protection of life and property against the possible effects of enemy attack. Reasonable costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire-fighting training, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the institution's premises pursuant to suggestions or requirements of civil defense authorities are allowable when distributed to all activities of the institution. Capital expenditures for civil defense purposes will not be allowed, but a use allowance or depreciation may be permitted in accordance with provisions set forth elsewhere. Costs of local civil defense projects not on the institution's premises are unallowable.

6. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage, and the like are allowable.

7. *Compensation for personal services*—a. *General.* Compensation for personal services covers all remuneration paid currently or accrued to employees of the hospital for services rendered during the period of performance under government research agreements. Such remuneration includes salaries, wages, staff benefits (see paragraph IX-B.10), and pension plan costs (see paragraph IX-B.25). The costs of such remuneration are allowable to the extent that the total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the institution consistently applied, and provided that the charges for work performed directly on government research agreements and for other work allocable as indirect costs to sponsored research are determined and supported as hereinafter provided. For non-profit, non-proprietary institutions, where federally supported programs constitute less than a preponderance of the activity at the institution the primary test of reasonableness will be to require that the institution's compensation policies be applied consistently both to federally-sponsored and non-sponsored activities alike. However, where special circumstances so dictate a contractual clause may be utilized which calls for application of the test of comparability in determining the reasonableness of compensation.

b. *Payroll distribution.* Amounts charged to organized research for personal services, regardless of whether treated as direct costs or

allocated as indirect costs, will be based on hospital payrolls which have been approved and documented in accordance with generally accepted hospital practices. In order to develop necessary direct and indirect allocations of cost, supplementary data on time or effort as provided in paragraph (c) below, normally need be required only for individuals whose compensation is properly chargeable to two or more research agreements or to two or more of the following broad functional categories: (1) Patient care; (2) organized research; (3) instruction and training; (4) indirect activities as defined in paragraph V-A; or (5) other hospital activities as defined in paragraph II-E.

c. *Reporting time or effort.* Charges for salaries and wages of individuals other than members of the professional staff will be supported by daily time and attendance and payroll distribution records. For members of the professional staff, current and reasonable estimates of the percentage distribution of their total effort may be used as support in the absence of actual time records. The term professional staff for purposes of this section includes physicians, research associates, and other personnel performing work at responsible levels of activities. These personnel normally fulfill duties, the competent performance of which usually requires persons possessing degrees from accredited institutions of higher learning and/or state licensure. In order to qualify as current and reasonable, estimates must be made no later than one month (though not necessarily a calendar month) after the month in which the services were performed.

d. *Preparation of estimates of effort.* Where required under paragraph (c) above, estimates of effort spent by a member of the professional staff on each research agreement should be prepared by the individual who performed the services or by a responsible individual such as a department head or supervisor having first-hand knowledge of the services performed on each research agreement. Estimates must show the allocation of effort between organized research and all other hospital activities in terms of the percentage of total effort devoted to each of the broad functional categories referred to in (b) above. The estimate of effort spent on a research agreement may include a reasonable amount of time spent in activities contributing and intimately related to work under the agreement, such as preparing and delivering special lectures about specific aspects of the ongoing research, writing research reports and articles, participating in appropriate research seminars, consulting with colleagues with respect to related research, and attending appropriate scientific meetings and conferences. The term "all other hospital activities" would include departmental research, administration, committee work, and public

services undertaken on behalf of the hospital.

e. *Application of budget estimates.* Estimates determined before the performance of services, such as budget estimates on a monthly, quarterly, or yearly basis do not qualify as estimates of effort spent.

f. *Non-hospital professional activities.* A hospital must not alter or waive hospital-wide policies and practices dealing with the permissible extent of professional services over and above those traditionally performed without extra hospital compensation, unless such arrangements are specifically authorized by the sponsoring agency. Where hospital-wide policies do not adequately define the permissible extent of consultancies or other non-hospital activities undertaken for extra pay, the Government may require that the effort of professional staff working under research agreements be allocated as between (1) hospital activities, and (2) non-hospital professional activities. If the sponsoring agency should consider the extent of non-hospital professional effort excessive, appropriate arrangements governing compensation will be negotiated on a case by case basis.

g. *Salary rates for part-time appointments.* Charges for work performed on government research by staff members having only part-time appointments will be determined at a rate not in excess of that for which he is regularly paid for his part-time staff assignment.

8. *Contingency provisions.* Contributions to a contingency reserve or any similar provisions made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable.

9. *Depreciation and use allowances.* a. Hospitals may be compensated for the use of buildings, capital improvements and usable equipment on hand through depreciation or use allowances. Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life has reference to the prospective period of economic usefulness in the particular hospital's operations as distinguished from physical life. Use allowances are the means of allowing compensation when depreciation or other equivalent costs are not considered.

b. Due consideration will be given to government-furnished research facilities utilized by the institution when computing use allowances and/or depreciation if the government-furnished research facilities are material in amount. Computation of the use allowance and/or depreciation will exclude both the cost or any portion of the cost of grounds, buildings and equipment borne by



or donated by the Federal Government, irrespective of where title was originally vested or where it presently resides, and secondly, the cost of grounds. Capital expenditures for land improvements (paved areas, fences, streets, sidewalks, utility conduits, and similar improvements not already included in the cost of buildings) are allowable provided the systematic amortization of such capital expenditures has been provided in the institution's books of accounts, based on reasonable determinations of the probable useful lives of the individual items involved, and the share allocated to organized research is developed from the amount thus amortized for the base period involved.

c. Normal depreciation on a hospital's plant, equipment, and other capital facilities, except as excluded by (d) below, is an allowable element of research cost provided that the amount thereof is computed:

1. Upon the property cost basis used by the hospital for Federal Income Tax purposes (See section 167 of the Internal Revenue Code of 1954); or

2. In the case of non-profit or tax exempt organizations, upon a property cost basis which could have been used by the hospital for Federal Income Tax purposes, had such hospital been subject to the payment of income tax; and in either case

3. By the consistent application to the assets concerned of any generally accepted accounting method, and subject to the limitations of the Internal Revenue Code of 1954 as amended, including—

- i. The straight line method;
- ii. The declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in (i) above;
- iii. The sum of the years-digits method; and
- iv. Any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the use of the property and including the current year, does not during the first two-thirds of the useful life of the property exceed the total of such allowances which would have been used had such allowances been computed under the method described in (ii) above.

d. Where the depreciation method is followed, adequate property records must be maintained. The period of useful service (service life) established in each case for usable capital assets must be determined on a realistic basis which takes into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular research area, and the renewal and replacement policies followed for the individual items or classes of assets involved. Where the depreciation method is introduced for application

to assets acquired in prior years, the annual charges therefrom must not exceed the amounts that would have resulted had the depreciation method been in effect from the date of acquisition of such assets.

e. Depreciation on idle or excess facilities shall not be allowed except on such facilities as are reasonably necessary for standby purposes.

f. Where an institution elects to go on a depreciation basis for a particular class of assets, no depreciation, rental or use charge may be allowed on any such assets that would be viewed as fully depreciated; provided, however, that reasonable use charges may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the actual replacement policy followed in the light of service lives used for calculating depreciation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

g. Hospitals which choose a depreciation allowance for assets purchased prior to 1966 based on a percentage of operating costs in lieu of normal depreciation for purposes of reimbursement under Pub. L. 89-97 (Medicare) shall utilize that method for determining depreciation applicable to organized research.

The operating costs to be used are the lower of the hospital's 1965 operating costs or the hospital's current year's allowable costs. The percent to be applied is 5 percent starting with the year 1966-67, with such percentage being uniformity reduced by one-half percent each succeeding year. The allowance based on operating costs is in addition to regular depreciation on assets acquired after 1965. However, the combined amount of such allowance on pre-1966 assets and the allowance for actual depreciation on assets acquired after 1965 may not exceed 6 percent of the hospital's allowable cost for the current year. After total depreciation has been computed, allocation methods are used to determine the share attributable to organized research.

For purposes of this section, *Operating Costs* means the total costs incurred by the hospital in operating the institution, and includes patient care, research, and other activities. *Allowable Costs* means operating costs less unallowable costs as defined in these principles; by the application of allocation methods to the total amount of such allowable costs, the share attributable to Federally-sponsored research is determined.

A hospital which elects to use this procedure under Pub. L. 89-97 and subsequently changes to an actual depreciation basis on pre-1966 assets in accordance with the option afforded under the Medicare program shall

simultaneously change to an actual depreciation basis for organized research.

Where the hospital desires to change to actual depreciation but either has no historical cost records or has incomplete records, the determination of historical cost could be made through appropriate means involving expert consultation with the determination being subject to review and approval by the Department of Health and Human Services.

h. Where the use allowance method is followed, the use allowance for buildings and improvements will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost of usable equipment in those cases where the institution maintains current records with respect to such equipment on hand. Where the institution's records reflect only the cost (actual or estimated) of the original complement of equipment, the use allowance will be computed at an annual rate not exceeding ten percent of such cost. Original complement for this purpose means the complement of equipment initially placed in buildings to perform the functions currently being performed in such buildings; however, where a permanent change in the function of a building takes place, a redetermination of the original complement of equipment may be made at that time to establish a new original complement. In those cases where no equipment records are maintained, the institution will justify a reasonable estimate of the acquisition cost of usable equipment which may be used to compute the use allowance at an annual rate not exceeding six and two-thirds percent of such estimate.

i. Depreciation and/or use charges should usually be allocated to research and other activities as an indirect cost.

10. *Employee morale, health, and welfare costs and credits.* The costs of house publications, health or first-aid benefits, recreational activities, employees' counseling services, and other expenses incurred in accordance with the hospital's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Such costs will be equitably apportioned to all activities of the hospital. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

11. *Entertainment costs.* Except as pertains to 10 above, costs incurred for amusement, social activities, entertainment, and any items relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable.

12. *Equipment and other facilities.* The cost of equipment or other facilities are allowable on a direct charge basis where such pur-

chases are approved by the sponsoring agency concerned or provided for by the terms of the research agreement.

13. *Fines and penalties.* Costs resulting from violations of, or failure of the institution to comply with federal, state and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the research agreement, or instructions in writing from the awarding agency.

14. *Insurance and indemnification.* a. Costs of insurance required or approved and maintained pursuant to the research agreement are allowable.

b. Costs of other insurance maintained by the hospital in connection with the general conduct of its activities are allowable subject to the following limitations: (1) Types and extent and cost of coverage must be in accordance with sound institutional practice; (2) costs of insurance or of any contributions to any reserve covering the risk of loss of or damage to government owned property are unallowable except to the extent that the Government has specifically required or approved such costs; and (3) costs of insurance on the lives of officers or trustees are unallowable except where such insurance is part of an employee plan which is not unduly restricted.

c. Contributions to a reserve for an approved self-insurance program are allowable to the extent that the types of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks. Such contributions are subject to prior approval of the Government.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the research agreement, except that costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice as well as minor losses not covered by insurance such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations are allowable.

15. *Interest, fund raising and investment management costs.* a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are not allowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are not allowable.

d. Costs related to the physical custody and control of monies and securities are allowable.

16. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the hospital and its employees, including costs of labor management committees, employees' publications, and other related activities are allowable.

17. *Losses on research agreements or contracts.* Any excess of costs over income under any agreement or contract of any nature is unallowable. This includes, but is not limited to, the hospital's contributed portion by reason of cost-sharing agreements, under-recoveries through negotiation of flat amounts for overhead, or legal or administrative limitations.

18. *Maintenance and repair costs.* a. Costs necessary for the upkeep of property (including government property unless otherwise provided for), which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows:

1. Normal maintenance and repair costs are allowable;

2. Extraordinary maintenance and repair costs are allowable, provided they are allocated to the periods to which applicable for purposes of determining research costs.

b. Expenditures for plant and equipment, including rehabilitation thereof, which according to generally accepted accounting principles as applied under the hospital's established policy, should be capitalized and subjected to depreciation, are allowable only on a depreciation basis.

19. *Material costs.* Costs incurred for purchased materials, supplies and fabricated parts directly or indirectly related to the research agreement, are allowable. Purchases made specifically for the research agreement should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the institution. Withdrawals from general stores or stockrooms should be charged at their cost under any recognized method of pricing stores withdrawals conforming to sound accounting practices consistently followed by the hospital. Incoming transportation charges are a proper part of material cost. Direct material cost should include only the materials and supplies actually used for the performance of the research agreement, and due credit should be given for any excess materials retained or returned to vendors. Due credit should be given for all proceeds or value received for any scrap resulting from work under the research agreement. Where government donated or furnished material is used in performing the research agreement, such material will be used without charge.

20. *Memberships, subscriptions and professional activity costs.* a. Costs of the hospital's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the hospital's subscriptions to civic, business, professional and technical periodicals are allowable.

c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such meetings or conferences.

21. *Organization costs.* Expenditures such as incorporation fees, attorneys' fees, accountants' fees, brokers' fees, fees to promoters and organizers in connection with (a) organization or reorganization of a hospital, or (b) raising capital, are unallowable.

22. *Other business expenses.* Included in this item are such recurring expenses as registry and transfer charges resulting from changes in ownership of securities issued by the hospital, cost of shareholders meetings preparation and publication of reports to shareholders, preparation and submission of required reports and forms to taxing and other regulatory bodies, and incidental costs of directors and committee meetings. The above and similar costs are allowable when allocated on an equitable basis.

23. *Patient care.* The cost of routine and ancillary or special services to research patients is an allowable direct cost of research agreements.

a. Routine services shall include the costs of the regular room, dietary and nursing services, minor medical and surgical supplies and the use of equipment and facilities for which a separate charge is not customarily made.

b. Ancillary or special services are the services for which charges are customarily made in addition to routine services, such as operating rooms, anesthesia, laboratory, BMR-EKG, etc.

c. Patient care, whether expressed as a rate or an amount, shall be computed in a manner consistent with the procedures used to determine reimbursable costs under Pub. L. 89-97 (Medicare Program) as defined under the "Principles Of Reimbursement For Provider Costs" published by the Social Security Administration of the Department of Health and Human Services. The allowability of specific categories of cost shall be in accordance with those principles rather than the principles for research contained herein. In the absence of participation in the Medicare program by a hospital, all references to the Medicare program in these principles shall be construed as meaning the Medicaid program.

i. Once costs have been recognized as allowable, the indirect costs or general service center's cost shall be allocated (stepped-

down) to special service centers, and all patient and nonpatient costs centers based upon actual services received or benefiting these centers.

ii. After allocation, routine and ancillary costs shall be apportioned to scatter-bed research patients on the same basis as is used to apportion costs to Medicare patients, i.e. using either the departmental method or the combination method, as those methods are defined by the Social Security Administration; except that final settlement shall be on a grant-by-grant basis. However, to the extent that the Social Security Administration has recognized any other method of cost apportionment, that method generally shall also be recognized as applicable to the determination of research patient care costs.

iii. A cost center must be established on Medicare reimbursement forms for each discrete-bed unit grant award received by a hospital. Routine costs should be stepped-down to this line item(s) in the normal course of stepping-down costs under Medicare/Medicaid requirements. However, in stepping-down routine costs, consideration must be given to preventing a step-down of those costs to discrete-bed unit line items that have already been paid for directly by the grant, such as bedside nursing costs. Ancillary costs allocable to research discrete-bed units shall be determined and proposed in accordance with Section 23.c.ii.

d. Where federally sponsored research programs provide specifically for the direct reimbursement of nursing, dietary, and other services, appropriate adjustment must be made to patient care costs to preclude duplication and/or misallocation of costs.

24. *Patent costs.* Costs of preparing disclosures, reports and other documents required by the research agreement and of searching the art to the extent necessary to make such invention disclosures are allowable. In accordance with the clauses of the research agreement relating to patents, costs of preparing documents and any other patent costs, in connection with the filing of a patent application where title is conveyed to the Government, are allowable. (See also paragraph IX-B.36.)

25. *Pension plan costs.* Costs of the hospital's pension plan which are incurred in accordance with the established policies of the institution are allowable, provided such policies meet the test of reasonableness and the methods of cost allocation are not discriminatory, and provided appropriate adjustments are made for credits or gains arising out of normal and abnormal employee turnover or any other contingencies that can result in forfeitures by employees which inure to the benefit of the hospital.

26. *Plan security costs.* Necessary expenses incurred to comply with government security requirements including wages, uniforms

and equipment of personnel engaged in plant protection are allowable.

27. *Preresearch agreement costs.* Costs incurred prior to the effective date of the research agreement, whether or not they would have been allowable thereunder if incurred after such date, are unallowable unless specifically set forth and identified in the research agreement.

28. *Professional services costs.* a. Costs of professional services rendered by the members of a particular profession who are not employees of the hospital are allowable subject to (b) and (c) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government. Retainer fees to be allowable must be reasonably supported by evidence of services rendered.

b. Factors to be considered in determining the allowability of costs in a particular case include (1) the past pattern of such costs, particularly in the years prior to the award of government research agreements on the institution's total activity; (2) the nature and scope of managerial services expected of the institution's own organizations; and (3) whether the proportion of government work to the hospital's total activity is such as to influence the institution in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under government research agreements.

c. Costs of legal, accounting and consulting services, and related costs incurred in connection with organization and reorganization or the prosecution of claims against the Government are unallowable. Costs of legal, accounting and consulting services, and related costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the research agreement.

29. *Profits and losses on disposition of plant equipment, or other assets.* Profits or losses of any nature arising from the sale or exchange of plant, equipment, or other capital assets, including sales or exchange of either short- or long-term investments, shall be excluded in computing research agreement costs.

30. *Proposal costs.* Proposal costs are the costs of preparing bids or proposals on potential government and non-government research agreements or projects, including the development of technical data and cost data necessary to support the institution's bids or proposals. Proposal costs of the current accounting period of both successful and unsuccessful bids and proposals normally should be treated as indirect costs and allocated currently to all activities of the institution, and no proposal costs of past accounting periods will be allocable in the current period to the government research agreement. However, the institution's established practices may be to treat proposal

costs by some other recognized method. Regardless of the methods used, the results obtained may be accepted only if found to be reasonable and equitable.

31. *Public information services costs.* Costs of news releases pertaining to specific research or scientific accomplishment are unallowable unless specifically authorized by the sponsoring agency.

32. *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special rearrangement and alteration costs incurred specifically for a project are allowable only as a direct charge when such work has been approved in advance by the sponsoring agency concerned.

33. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the institution's facilities to approximately the same condition existing immediately prior to commencement of government research agreement work, fair wear and tear excepted, are allowable.

34. *Recruiting costs.* a. Subject to (b), (c), and (d) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees are allowable to the extent that such costs are incurred pursuant to a well managed recruitment program. Where an institution uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

b. In publications, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal institutional practices in this respect) are unallowable.

c. Costs of help wanted advertising, special emoluments; fringe benefits, and salary allowances incurred to attract professional personnel from other institutions that do not meet the test of reasonableness or do not conform with the established practices of the institution are unallowable.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve months after hire, the institution will be required to refund or credit such relocation costs as were charged to the Government.

35. *Rental costs (including sale and lease-back of facilities).* a. Rental costs of land, building, and equipment and other personal property are allowable if the rates are reasonable in light of such factors as rental costs of comparable facilities and market conditions in the area, the type, life expectancy, condition, and value of the facilities leased, options available, and other provisions of the rental agreement. Application of these factors, in situations where rentals are extensively used, may involve among other considerations comparison of rental costs with the amount which the hospital would have received had it owned the facilities.

b. Charges in the nature of rent between organizations having a legal or other affiliation or arrangement such as hospitals, medical schools, foundations, etc., are allowable to the extent such charges do not exceed the normal costs of ownership such as depreciation, taxes, insurance, and maintenance, provided that no part of such costs shall duplicate any other allowed costs.

c. Unless otherwise specifically provided in the agreement, rental costs specified in sale and lease-back agreements incurred by hospitals through selling plant facilities to investment organizations such as insurance companies or to private investors, and concurrently leasing back the same facilities are allowable only to the extent that such rentals do not exceed the amount which the hospital would have received had it retained legal title to the facilities.

36. *Royalties and other costs for use of patents.* Royalties on a patent or amortization of the cost of acquiring a patent or invention or rights thereto necessary for the proper performance of the research agreement and applicable to tasks or processes thereunder are allowable unless the Government has a license or the right to free use of the patent, the patent has been adjudicated to be invalid, or has been administratively determined to be invalid, the patent is considered to be unenforceable, or the patent has expired.

37. *Severance pay.* a. Severance pay is compensation in addition to regular salaries and wages which is paid by a hospital to employees whose services are being terminated. Costs of severance pay are allowable only to the extent that such payments are required by law, by employer-employee agreement, by established policy that constitutes in effect an implied agreement on the institution's part, or by circumstances of the particular employment.

b. Severance payments that are due to normal, recurring turnover, and which otherwise meet the conditions of (a) above may be allowed provided the actual costs of such severance payments are regarded as expenses applicable to the current fiscal year and are equitably distributed among the institution's activities during that period.

c. Severance payments that are due to abnormal or mass terminations are of such conjectural nature that allowability must be determined on a case-by-case basis. However, the Government recognizes its obligation to participate to the extent of its fair share in any specific payment.

38. *Specialized service facilities operated by a hospital.* a. The costs of institutional services involving the use of highly complex and specialized facilities such as electronic computers and reactors are allowable provided the charges therefor meet the conditions of (b) or (c) below, and otherwise take into account any items of income or federal financing that qualify as applicable credits under paragraph III-E.

b. The costs of such hospital services normally will be charged directly to applicable research agreements based on actual usage or occupancy of the facilities at rates that (1) are designed to recover only actual costs of providing such services, and (2) are applied on a nondiscriminatory basis as between organized research and other work of the hospital including commercial or accommodation sales and usage by the hospital for internal purposes. This would include use of such facilities as radiology, laboratories, maintenance men used for a special purpose, medical art, photography, etc.

c. In the absence of an acceptable arrangement for direct costing as provided in (b) above, the costs incurred for such institutional services may be assigned to research agreements as indirect costs, provided the methods used achieve substantially the same results. Such arrangements should be worked out in coordination with all government users of the facilities in order to assure equitable distribution of the indirect costs.

39. *Special administrative costs.* Costs incurred for general public relations activities, catalogs, alumni activities, and similar services are unallowable.

40. *Staff and/or employee benefits.* a. Staff and/or employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job such as for annual leave, sick leave, military leave and the like are allowable provided such costs are absorbed by all hospital activities including organized research in proportion to the relative amount of time or effort actually devoted to each.

b. Staff benefits in the form of employer contributions or expenses for Social Security taxes, employee insurance, Workmen's Compensation insurance, the Pension Plan (see paragraph IX-B.25), hospital costs or remission of hospital charges to the extent of costs for individual employees or their families, and the like are allowable provided such benefits are granted in accordance with established hospital policies, and provided such contributions and other expenses whether treated as indirect costs or an incre-

ment of direct labor costs are distributed to particular research agreements and other activities in a manner consistent with the pattern of benefits accruing to the individuals or groups of employees whose salaries and wages are chargeable to such research agreements and other activities.

41. *Taxes.* a. In general, taxes which the hospital is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable except for (1) taxes from which exemptions are available to the hospital directly or which are available to the hospital based on an exemption afforded the Government and in the latter case when the sponsoring agency makes available the necessary exemption certificates, (2) special assessments on land which represent capital improvements, and (3) Federal Income Taxes.

b. Any refund of taxes, interest, or penalties, and any payment to the hospital of interest thereon attributable to taxes, interest or penalties, which were allowed as research agreement costs will be credited or paid to the Government in the manner directed by the Government provided any interest actually paid or credited to a hospital incident to a refund of tax, interest, and penalty will be paid or credited to the Government only to the extent that such interest accrued over the period during which the hospital had been reimbursed by the Government for the taxes, interest, and penalties.

42. *Transportation costs.* Costs incurred for inbound freight, express, cartage, postage and other transportation services relating either to goods purchased, in process, or delivered are allowable. When such costs can readily be identified with the items involved, they may be charged directly as transportation costs or added to the cost of such items. Where identification with the material received cannot readily be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the institution follows a consistent equitable procedure in this respect. Outbound freight, if reimbursable under the terms of the research agreement, should be treated as a direct cost.

43. *Travel costs.* a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the hospital. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed by the institution in its regular operations.

b. Travel costs are allowable subject to (c) and (d) below when they are directly attributable to specific work under a research agreement or when they are incurred in the normal course of administration of the hospital or a department or research program thereof.

c. The difference in cost between first class air accommodations and less than first class air accommodations is unallowable except when less than first class air accommodations are not reasonably available to meet necessary mission requirements such as where less than first class accommodations would (1) require circuitous routing, (2) require travel during unreasonable hours, (3) greatly increase the duration of the flight, (4) result in additional costs which would offset the transportation savings, or (5) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Costs of personnel movements of a special or mass nature are allowable only when authorized or approved in writing by the sponsoring agency or its authorized representative.

44. *Termination costs applicable to contracts.* a. Contract terminations generally give rise to the incurrence of costs or to the need for special treatment of costs which would not have arisen had the contract not been terminated. Items peculiar to termination are set forth below. They are to be used in conjunction with all other provisions of these principles in the case of contract termination.

b. The cost of common items of material reasonably usable on the hospital's other work will not be allowable unless the hospital submits evidence that it could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the institution, consideration should be given to the hospital's plans for current scheduled work or activities including other research agreements. Contemporaneous purchases of common items by the hospital will be regarded as evidence that such items are reasonably usable on the hospital's other work. Any acceptance of common items as allowable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirement of other work.

c. If in a particular case, despite all reasonable efforts by the hospital, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in these principles, except that any such costs continuing after termination due to the negligent or willful failure of the hospital to discontinue such costs will be considered unacceptable.

d. Loss of useful value of special tooling and special machinery and equipment is generally allowable, provided (1) such special tooling, machinery or equipment is not reasonably capable of use in the other work of the hospital; (2) the interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer; and (3) the loss of useful value as to any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other government contracts for which the special tooling, special machinery or equipment was acquired.

e. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated contract, less the residual value of such leases, if (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and (2) the hospital makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the contract and of reasonable restoration required by the provisions of the lease.

f. Settlement expenses including the following are generally allowable: (1) Accounting, legal, clerical, and similar costs reasonably necessary for the preparation and presentation to contracting officers of settlement claims and supporting data with respect to the terminated portion of the contract and the termination and settlement of subcontracts; and (2) reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced by the institution for the contract.

g. Subcontractor claims including the allocable portion of claims which are common to the contract and to other work of the contractor are generally allowable.

45. *Voluntary services.* The value of voluntary services provided by sisters or other members of religious orders is allowable provided that amounts do not exceed that paid other employees for similar work. Such amounts must be identifiable in the records of the hospital as a legal obligation of the hospital. This may be reflected by an agreement between the religious order and the hospital supported by evidence of payments to the order.

Department of Health and Human Services

Pt. 74, App. I

APPENDIXES F—H TO PART 74  
[RESERVED]

APPENDIX I TO PART 74—OMB CIRCULAR  
A-133 AUDITS OF INSTITUTIONS OF  
HIGHER EDUCATION AND OTHER NON-  
PROFIT INSTITUTIONS

OMB Circular No. A-133

To the Heads of Executive Departments and  
Establishments

Subject: Audits of Institutions of Higher  
Education and Other Nonprofit Institu-  
tions

1. *Purpose.* Circular A-133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.

2. *Authority.* Circular A-133 is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541.

3. *Supersession.* Circular A-133 supersedes Attachment F, subparagraph 2h, of Circular A-110, "Uniform Administrative Requirements for Grants and other Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations."

4. *Applicability.* The provisions of Circular A-133 apply to:

a. Federal departments and agencies responsible for administering programs that involve grants, cost-type contracts and other agreements with institutions of higher education and other nonprofit recipients.

b. Nonprofit institutions, whether they are recipients, receiving awards directly from Federal agencies, or are sub-recipients, receiving awards indirectly through other recipients.

These principles, to the extent permitted by law, constitute guidance to be applied by agencies consistent with and within the discretion, conferred by the statutes governing agency action.

5. *Requirements and Responsibilities.* The specific requirements and responsibilities of Federal departments and agencies and institutions of higher education and other nonprofit institutions are set forth in the attachment.

6. *Effective Date.* The provisions of Circular A-133 are effective upon publication and shall apply to audits of nonprofit institutions for fiscal years that begin on or after January 1, 1990. Earlier implementation is encouraged. However, until this Circular is implemented, the audit provisions of Attachment F to Circular A-110 shall continue to be observed.

7. *Policy Review (Sunset) Date.* Circular A-133 will have a policy review three years from the date of issuance.

8. *Inquiries.* Further information concerning Circular A-133 may be obtained by contacting the Financial Management Division, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

Richard G. Darman, '  
Director.

OMB CIRCULAR A-133

AUDITS OF INSTITUTIONS OF HIGHER EDU-  
CATION AND OTHER NONPROFIT INSTITUTIONS

1. *Definitions.* For the purposes of this Circular, the following definitions apply:

a. *Award* means financial assistance, and Federal cost-type contracts used to buy services or goods for the use of the Federal Government. It includes awards received directly from the Federal agencies or indirectly through recipients. It does not include procurement contracts to vendors under grants or contracts, used to buy goods or services. Audits of such vendors shall be covered by the terms and conditions of the contract.

b. *Cognizant agency* means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 3 of this Attachment.

c. *Coordinated audit approach* means an audit wherein the independent auditor, and other Federal and non-federal auditors consider each other's work, in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with *Government Auditing Standards* and meet the objectives and reporting requirements set forth in paragraph 12(b) and 15, respectively, of this Attachment. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner.

d. *Federal agency* has the same meaning as the term 'agency' in section 551(l) of title 5, United States Code.

e. *Federal Financial Assistance.*

(1) *Federal financial assistance* means assistance provided by a Federal agency to a recipient or sub-recipient to carry out a program. Such assistance may be in the form of:

- Grants;
- Contracts;
- Cooperative agreements;
- Loans;
- Loan guarantees;
- Property;
- Interest subsidies;
- Insurance;
- Direct appropriations;
- Other non-cash assistance.



(2) Such assistance does not include direct Federal cash assistance to individuals.

(3) Such assistance includes awards received directly from Federal agencies, or indirectly when sub-recipients receive funds identified as Federal funds by recipients.

(4) The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to sub-recipients.

f. *Generally accepted accounting principles* has the meaning specified in the *Government Auditing Standards*.

g. *Independent auditor* means:

(1) A Federal, State, or local government auditor who meets the standards specified in the *Government Auditing Standards*; or

(2) A public accountant who meets such standards.

h. *Internal control structure* means the policies and procedures established to provide reasonable assurance that:

(1) Resource use is consistent with laws, regulations, and award terms;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

i. *Major program* means an individual award or a number of awards in a category of Federal assistance or support for which total expenditures are the larger of three percent of total Federal funds expended or \$100,000, on which the auditor will be required to express an opinion as to whether the major program is being administered in compliance with laws and regulations.

Each of the following categories of Federal awards shall constitute a major program where total expenditures are the larger of three percent of total Federal funds expended or \$100,000:

—Research and Development.

—Student Financial Aid.

—Individual awards not in the student aid or research and development category.

j. *Management decision* means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary.

k. *Nonprofit institution* means any corporation, trust, association, cooperative or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. The term *nonprofit institutions* includes institutions of higher education, except those institutions that are audited as part of single au-

dits in accordance with Circular A-128 Audits of State and Local Governments.” The term does not include hospitals which are not affiliated with an institution of higher education, or State and local governments and Indian tribes covered by Circular A-128 “Audits of State and Local Governments.”

l. *Oversight agency* means the Federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency, unless no direct funding is received. Where there is no direct funding, the Federal agency with the predominant indirect funding will assume the general oversight responsibilities. The duties of the oversight agency are described in paragraph 4 of this Attachment.

m. *Recipient* means an organization receiving financial assistance to carry out a program directly from Federal agencies.

n. *Research and development* includes all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other nonprofit institutions. *Research* is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. *Development* is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

o. *Student Financial Aid* includes those programs of general student assistance in which institutions participate, such as those authorized by Title IV of the Higher Education Act of 1965 which is administered by the U.S. Department of Education and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar awards to students on a competitive basis, or for specified studies or research.

p. *Sub-recipient* means any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other sub-recipient, but does not include an individual that is a beneficiary of such a program. A sub-recipient may also be a direct recipient of Federal awards under other agreements.

q. *Vendor* means an organization providing a recipient or sub-recipient with generally required goods or services that are related to the administrative support of the Federal assistance program.

## 2. Audit of Nonprofit Institutions.

a. *Requirements based on awards received.* (1) Nonprofit institutions that receive \$100,000 or more a year in Federal awards shall have an audit made in accordance with the provisions of this Circular. However, nonprofit institutions receiving \$100,000 or more but receiving awards under only one program have

the option of having an audit of their institution prepared in accordance with the provisions of the Circular or having an audit made of the one program. For prior or subsequent years, when an institution has only loan guarantees or outstanding loans that were made previously, the institution may be required to conduct audits for those programs, in accordance with regulations of the Federal agencies providing those guarantees or loans.

(2) Nonprofit institutions that receive at least \$25,000 but less than \$100,000 a year in Federal awards shall have an audit made in accordance with this Circular or have an audit made of each Federal award, in accordance with Federal laws and regulations governing the programs in which they participate.

(3) Nonprofit institutions receiving less than \$25,000 a year in Federal awards are exempt from Federal audit requirements, but records must be available for review by appropriate officials of the Federal grantor agency or subgranting entity.

b. *Oversight by Federal agencies.* (1) To each of the larger nonprofit institutions the Office of Management and Budget (OMB) will assign a Federal agency as the cognizant agency for monitoring audits and ensuring the resolution of audit findings that affect the programs of more than one agency.

(2) Smaller institutions not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most funds.

(3) Assignments to Federal cognizant agencies for carrying out responsibilities in this section are set forth in a separate supplement to this Circular.

(4) Federal Government-owned, contractor-operated facilities at institutions or laboratories operated primarily for the Government are not included in the cognizance assignments. These will remain the responsibility of the contracting agencies. The listed assignments cover all of the functions in this Circular unless otherwise indicated. The Office of Management and Budget will coordinate changes in agency assignments.

3. *Cognizant Agency Responsibilities.* A cognizant agency shall:

a. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

b. Provide technical advice and liaison to institutions and independent auditors.

c. Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

d. Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. A cognizant agency

should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

e. Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

f. Coordinate, to the extent practicable, audits or reviews made for Federal agencies that are in addition to the audits made pursuant to this Circular, so that the additional audits or reviews build upon audits performed in accordance with the Circular.

g. Ensure the resolution of audit findings that affect the programs of more than one agency.

h. Seek the views of other interested agencies before completing a coordinated program.

i. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

4. *Oversight agency responsibilities.* An oversight agency shall provide technical advice and counsel to institutions and independent auditors when requested by the recipient. The oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency.

5. *Recipient responsibilities.* A recipient that receives a Federal award and provides \$25,000 or more of it during its fiscal year to a sub-recipient shall:

a. Ensure that the nonprofit institution sub-recipients that receive \$25,000 or more have met the audit requirements of this Circular, and that sub-recipients subject to OMB Circular A-128 have met the audit requirements of that Circular;

b. Ensure that appropriate corrective action is taken within six months after receipt of the sub-recipient audit report in instances of noncompliance with Federal laws and regulations;

c. Consider whether sub-recipient audits necessitate adjustment of the recipient's own records; and

d. Require each sub-recipient to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this Circular.

6. *Relation to Other Audit Requirements.*

a. An audit made in accordance with this Circular shall be in lieu of any financial

audit required under individual Federal awards. To the extent that an audit made in accordance with this Circular provides Federal agencies with the information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits or reviews necessary to carry out responsibilities under Federal law and regulation. Any additional Federal audits or reviews shall be planned and carried out in such a way as to build upon work performed by the independent auditor.

b. Audit planning by Federal audit agencies should consider the extent to which reliance can be placed upon work performed by other auditors. Such auditors include State, local, Federal, and other independent auditors, and a recipient's internal auditors. Reliance placed upon the work of other auditors should be documented and in accordance with *Government Auditing Standards*.

c. The provisions of this Circular do not limit the authority of Federal agencies to make or contract for audits and evaluations of Federal awards, nor do they limit the authority of any Federal agency Inspector General or other Federal official.

d. The provisions of this Circular do not authorize any institution or sub-recipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits, evaluations or reviews.

e. A Federal agency that makes or contracts for audits, in addition to the audits made by recipients pursuant to this Circular, shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits or reviews include financial, performance audits and program evaluations.

7. *Frequency of audit.* Audits shall usually be performed annually but not less frequently than every two years.

8. *Sanctions.* No audit costs may be charged to Federal awards when audits required by this Circular have not been made or have been made but not in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit in accordance with the Circular, Federal agencies must consider appropriate sanctions including:

- Withholding a percentage of awards until the audit is completed satisfactorily;
- Withholding or disallowing overhead costs; or
- Suspending Federal awards until the audit is made.

9. *Audit costs.* The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provisions of

Circular A–21, “Cost Principles for Universities” or Circular A–122, “Cost Principles for Nonprofit Organizations,” FAR subpart 31, or other applicable cost principles or regulations.

10. *Auditor selection.* In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A–110, “Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations.”

11. *Small and Minority Audit Firms.*

a. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular.

b. Recipients of Federal awards shall take the following steps to further this goal:

(1) Ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;

(2) Make information on forthcoming opportunities available and arrange timeframes for the audit to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(3) Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(4) Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs, and in cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;

(5) Encourage contracting with consortiums of small audit firms as described in section (1), above, when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals; and

(6) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

12. *Scope of Audit and Audit Objectives.* a. The audit shall be made by an independent auditor in accordance with *Government Auditing Standards* developed by the Comptroller General of the United States covering financial audits. An audit under this Circular should be an organization-wide audit of the institution. However, there may be instances where Federal auditors are performing audits or are planning to perform audits at

nonprofit institutions. In these cases, to minimize duplication of audit work, a coordinated audit approach may be agreed upon between the independent auditor, the recipient and the cognizant agency or the oversight agency. Those auditors who assume responsibility for any or all of the reports called for by paragraph 15 should follow guidance set forth in *Government Auditing Standards* in using work performed by others.

b. The auditor shall determine whether:

(1) The financial statements of the institution present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles;

(2) The institution has an internal control structure to provide reasonable assurance that the institution is managing Federal awards in compliance with applicable laws and regulations, and controls that ensure compliance with the laws and regulations that could have a material impact on the financial statements; and

(3) The institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major Federal program.

13. *Internal Controls Over Federal Awards; Compliance Reviews.* a. *General.* The independent auditor shall determine and report on whether the recipient has an internal control structure to provide reasonable assurance that it is managing Federal awards in compliance with applicable laws, regulations, and contract terms, and that it safeguards Federal funds. In performing these reviews, independent auditors should rely upon work performed by a recipient's internal auditors to the maximum extent possible. The extent of such reliance should be based upon the *Government Auditing Standards*.

b. *Internal control review.* (1) In order to provide this assurance on internal controls, the auditor must obtain an understanding of the internal control structure and assess levels of internal control risk. After obtaining an understanding of the controls, the assessment must be made whether or not the auditor intends to place reliance on the internal control structure.

(2) As part of this review, the auditor shall:

(a) Perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. Tests of controls will not be required for those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or a material weakness should be reported in accordance with paragraph 15c(2) of this Circular.

(b) Review the recipient's system for monitoring sub-recipients and obtaining and acting on sub-recipient audit reports.

(c) Determine whether controls are in effect to ensure direct and indirect costs were computed and billed in accordance with the guidance provided in the general requirements section of the compliance supplement to this Circular.

c. *Compliance review.* (1) The auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. In addition, transactions selected for non-major programs shall be tested for compliance with Federal laws and regulations that apply to such transactions.

(2) In order to determine which major programs are to be tested for compliance, recipients shall identify, in their accounts, all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies, through other State and local governments or other recipients. To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the *Catalog of Federal Domestic Assistance* (CFDA) numbers to the recipients when making the awards.

(3) The review must include the selection of an adequate number of transactions from each major Federal financial assistance program so that the auditor obtains sufficient evidence to support the opinion on compliance required by paragraph 15c(3) of this Attachment. The selection and testing of transactions shall be based on the auditors' professional judgment considering such factors as the amount of expenditures for the program; the newness of the program or changes in its conditions; prior experience with the program particularly as revealed in audits and other evaluations (e.g., inspections, program reviews, or system reviews required by Federal Acquisition Regulations); the extent to which the program is carried out through sub-recipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(4) In making the test of transactions, the auditor shall determine whether:

—The amounts reported as expenditures were for allowable services, and  
—The records show that those who received services or benefits were eligible to receive them.

(5) In addition to transaction testing, the auditor shall determine whether:

- Matching requirements, levels of effort and earmarking limitations were met,
- Federal financial reports and claims for advances and reimbursement contain information that is supported by books and records from which the basic financial statements have been prepared, and
- Amounts claimed or used for matching were determined in accordance with (1) OMB Circular A-21, “Cost Principles for Educational Institutions”; (2) matching or cost sharing requirements in Circular A-110, “Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations”; (3) Circular A-122, “Cost Principles for Nonprofit Organizations”; (4) FAR subpart 31 cost principles; and (5) other applicable cost principles or regulations.

(6) The principal compliance requirements of the largest Federal programs may be ascertained by referring to the *Compliance Supplement for Single Audits of Educational Institutions and Other Nonprofit Organizations*, and the *Compliance Supplement for Single Audits of State and Local Governments*, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplements, the auditor should ascertain compliance requirements by reviewing the statutes, regulations, and agreements governing individual programs.

(7) Transactions related to other awards that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

14. *Illegal Acts.* If, during or in connection with the audit of a nonprofit institution, the auditor becomes aware of illegal acts, such acts shall be reported in accordance with the provisions of the *Government Auditing Standards*.

15. *Audit Reports.* a. Audit reports must be prepared at the completion of the audit.

b. The audit report shall state that the audit was made in accordance with the provisions of this Circular.

c. The report shall be made up of at least the following three parts:

(1) The financial statements and a schedule of Federal awards and the auditor's report on the statements and the schedule. The schedule of Federal awards should identify major programs and show the total expenditures for each program. Individual major programs other than Research and Development and Student Aid should be listed by catalog number as identified in the *Catalog of Federal Domestic Assistance*. Expenditures for Federal programs other than major programs shall be shown under the caption “other Federal assistance.” Also, the value of non-cash assistance such as loan guarantees, food com-

modities or donated surplus properties or the outstanding balance of loans should be disclosed in the schedule.

(2) A written report of the independent auditor's understanding of the internal control structure and the assessment of control risk. The auditor's report should include as a minimum: (1) The scope of the work in obtaining understanding of the internal control structure and in assessing the control risk, (2) the nonprofit institution's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and those that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations, and (3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk. If the auditor limits his/her consideration of the internal control structure for any reason, the circumstances should be disclosed in the report.

(3) The auditor's report on compliance containing:

—An opinion as to whether each major Federal program was being administered in compliance with laws and regulations applicable to the matters described in paragraph 13(c)(3) of this Attachment, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements;

—A statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested;

—Material findings of noncompliance presented in their proper perspective:

- The size of the universe in number of items and dollars,

- The number and dollar amount of transactions tested by the auditors,

- The number and corresponding dollar amount of instances of noncompliance;

—Where findings are specific to a particular Federal award, an identification of total amounts questioned, if any, for each Federal award, as a result of noncompliance and the auditor's recommendations for necessary corrective action.

c. The three parts of the audit report may be bound into a single document, or presented at the same time as separate documents.

d. Nonmaterial findings need not be disclosed with the compliance report but should be reported in writing to the recipient in a separate communication. The recipient, in turn, should forward the findings to the Federal grantor agencies or subgrantor sources.

e. All fraud or illegal acts or indications of such acts, including all questioned costs

found as the result of these acts that auditors become aware of, may be covered in a separate written report submitted in accordance with the *Government Auditing Standards*.

f. The auditor's report should disclose the status of known but uncorrected significant material findings and recommendations from prior audits that affect the current audit objective as specified in the *Government Auditing Standards*.

g. In addition to the audit report, the recipient shall provide a report of its comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

h. Copies of the audit report shall be submitted in accordance with the reporting standards for financial audits contained in the *Government Auditing Standards*. Sub-recipient auditors shall submit copies to recipients that provided Federal awards. The report shall be due within 30 days after the completion of the audit, but the audit should be completed and the report submitted not later than 13 months after the end of the recipient's fiscal year unless a longer period is agreed to with the cognizant or oversight agency.

i. Recipients of more than \$100,000 in Federal awards shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audit reports on file.

j. Recipients shall keep audit reports, including sub-recipient reports, on file for three years from their issuance.

16. *Audit resolution.* a. As provided in paragraph 3, the cognizant agency shall be responsible for ensuring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and the agency. Alternate arrangements may be made on case-by-case basis by agreement among the agencies concerned.

b. A management decision shall be made within six months after receipt of the report by the Federal agencies responsible for audit resolution. Corrective action should proceed as rapidly as possible.

17. *Audit Workpapers and Reports.* Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee

or the General Accounting Office, at the completion of the audit.

[56 FR 8714, Mar. 1, 1991]

#### APPENDIX J TO PART 74—OMB CIRCULAR A-128, "AUDITS OF STATE AND LOCAL GOVERNMENTS"

*Circular No. A-128*

April 12, 1985.

To the Heads of Executive Departments and Establishments

Subject: Audits of State and Local Governments.

1. *Purpose.* This Circular is issued pursuant to the Single Audit Act of 1984, Pub. L. 98-502. It establishes audit requirements for State and local governments that receive Federal aid, and defines Federal responsibilities for implementing and monitoring those requirements.

2. *Supersession.* The Circular supersedes Attachment P, "Audit Requirements," of Circular A-102, "Uniform requirements for grants to State and local governments."

3. *Background.* The Single Audit Act builds upon earlier efforts to improve audits of Federal aid programs. The Act requires State or local governments that receive \$100,000 or more a year in Federal funds to have an audit made for that year. Section 7505 of the Act requires the Director of the Office of Management and Budget to prescribe policies, procedures and guidelines to implement the Act. It specifies that the Director shall designate "cognizant" Federal agencies, determine criteria for making appropriate charges to Federal programs for the cost of audits, and provide procedures to assure that small firms or firms owned and controlled by disadvantaged individuals have the opportunity to participate in contracts for single audits.

4. *Policy.* The Single Audit Act requires the following:

a. State or local governments that receive \$100,000 or more a year in Federal financial assistance shall have an audit made in accordance with this Circular.

b. State or local governments that receive between \$25,000 and \$100,000 a year shall have an audit made in accordance with this Circular, or in accordance with Federal laws and regulations governing the programs they participate in.

c. State or local governments that receive less than \$25,000 a year shall be exempt from compliance with the Act and other Federal audit requirements. These State and local governments shall be governed by audit requirements prescribed by State or local law or regulation.

d. Nothing in this paragraph exempts State or local governments from maintaining records of Federal financial assistance or

from providing access to such records to Federal agencies, as provided for in Federal law or in Circular A-102, "Uniform requirements for grants to state or local governments."

5. *Definitions.* For the purposes of this Circular the following definitions from the Single Audit Act apply:

a. *Cognizant agency* means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 11 of this Circular.

b. *Federal financial assistance* means assistance provided by a Federal agency in the form of grants, contracts, cooperative agreements, loans, loan guarantees, property, interest subsidies, insurance, or direct appropriations, but does not include direct Federal cash assistance to individuals. It includes awards received directly from Federal agencies, or indirectly through other units of States and local governments.

c. *Federal agency* has the same meaning as the term 'agency' in section 551(1) of Title 5, United States Code.

d. *Generally accepted accounting principles* has the meaning specified in the generally accepted government auditing standards.

e. *Generally accepted government auditing standards* means the *Standards For Audit of Government Organizations, Programs, Activities, and Functions*, developed by the Comptroller General, dated February 27, 1981.

f. *Independent auditor* means:

(1) A State or local government auditor who meets the independence standards specified in generally accepted government auditing standards; or

(2) A public accountant who meets such independence standards.

g. *Internal controls* means the plan of organization and methods and procedures adopted by management to ensure that:

(1) Resource use is consistent with laws, regulations, and policies;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

h. *Indian tribe* means any Indian tribe, band, nations, or other organized group or community, including any Alaskan Native village or regional or village corporations (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

i. *Local government* means any unit of local government within a State, including a county, a borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of government, and any other instrumentality of local government.

j. *Major Federal Assistance Program*, as defined by Pub. L. 98-502, is described in the Attachment to this Circular.

k. *Public accountants* means those individuals who meet the qualification standards included in generally accepted government auditing standards for personnel performing government audits.

l. *State* means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, and any multi-State, regional, or interstate entity that has governmental functions and any Indian tribe.

m. *Subrecipient* means any person or government department, agency, or establishment that receives Federal financial assistance to carry out a program through a State or local government, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a direct recipient of Federal financial assistance.

6. *Scope of audit.* The Single Audit Act provides that:

a. The audit shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial and compliance audits.

b. The audit shall cover the entire operations of a State or local government or, at the option of that government, it may cover departments, agencies or establishments that received, expended, or otherwise administered Federal financial assistance during the year. However, if a State or local government receives \$25,000 or more in General Revenue Sharing Funds in a fiscal year, it shall have an audit of its entire operations. A series of audits of individual departments, agencies, and establishments for the same fiscal year may be considered a single audit.

c. Public hospitals and public colleges and universities may be excluded from State and local audits and the requirements of this Circular. However, if such entities are excluded, audits of these entities shall be made in accordance with statutory requirements and the provisions of Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations."

d. The auditor shall determine whether:

(1) The financial statements of the government, department, agency or establishment present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;

(2) The organization has internal accounting and other control systems to provide reasonable assurance that it is managing Federal financial assistance programs in compliance with applicable laws and regulations; and

(3) The organization has complied with laws and regulations that may have material effect on its financial statements and on each major Federal assistance program.

7. *Frequency of audit.* Audits shall be made annually unless the State or local government has, by January 1, 1987, a constitutional or statutory requirement for less frequent audits. For those governments, the cognizant agency shall permit biennial audits, covering both years, if the government so requests. It shall also honor requests for biennial audits by governments that have an administrative policy calling for audits less frequent than annual, but only for fiscal years beginning before January 1, 1987.

8. *Internal control and compliance reviews.* The Single Audit Act requires that the independent auditor determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

a. *Internal control review.* In order to provide this assurance the auditor must make a study and evaluation of internal control systems used in administering Federal assistance programs. The study and evaluation must be made whether or not the auditor intends to place reliance on such systems. As part of this review, the auditor shall:

(1) Test whether these internal control systems are functioning in accordance with prescribed procedures.

(2) Examine the recipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports.

b. *Compliance review.* The law also requires the auditor to determine whether the organization has complied with laws and regulations that may have a material effect on each major Federal assistance program.

(1) In order to determine which major programs are to be tested for compliance, State and local governments shall identify in their accounts all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies and through other State and local governments.

(2) The review must include the selection and testing of a representative number of charges from each major Federal assistance program. The selection and testing of transactions shall be based on the auditor's professional judgment considering such factors as the amount of expenditures for the program and the individual awards; the newness of the program or changes in its conditions; prior experience with the program, particularly as revealed in audits and other evaluations (e.g., inspections program reviews); the extent to which the program is carried out through subrecipients; the extent to which the program contracts for goods or services; the level to which the program is already

subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(a) In making the test of transactions, the auditor shall determine whether:

- The amounts reported as expenditures were for allowable services, and
- The records show that those who received services or benefits were eligible to receive them.

(b) In addition to transaction testing, the auditor shall determine whether:

- Matching requirements, levels of effort and earmarking limitations were met,
- Federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared, and
- Amounts claimed or used for matching were determined in accordance with OMB Circular A-87, "Cost principles for State and local governments," and Attachment F of Circular A-102, "Uniform requirements for grants to State and local governments."

(c) The principal compliance requirements of the largest Federal aid programs may be ascertained by referring to the *Compliance Supplement for Single Audits of State and Local Governments*, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplement, the auditor may ascertain compliance requirements by researching the statutes, regulations, and agreements governing individual programs.

(3) Transactions related to other Federal assistance programs that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

9. *Subrecipients.* State or local governments that receive Federal financial assistance and provide \$25,000 or more of it in a fiscal year to a subrecipient shall:

a. Determine whether State or local subrecipients have met the audit requirements of this Circular and whether subrecipients covered by Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations," have met that requirement;

b. Determine whether the subrecipient spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subrecipient made in accordance with this Circular, Circular A-110,



or through other means (e.g., program reviews) if the subrecipient has not yet had such an audit;

c. Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of non-compliance with Federal laws and regulations;

d. Consider whether subrecipient audits necessitate adjustment of the recipient's own records; and

e. Require each subrecipient to permit independent auditors to have access to the records and financial statements as necessary to comply with this Circular.

10. *Relation to other audit requirements.* The Single Audit Act provides that an audit made in accordance with this Circular shall be in lieu of any financial or financial compliance audit required under individual Federal assistance programs. To the extent that a single audit provides Federal agencies with information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits which are necessary to carry out its responsibilities under Federal law and regulation. Any additional Federal audit effort shall be planned and carried out in such a way as to avoid duplication.

a. The provisions of this Circular do not limit the authority of Federal agencies to make, or contract for audits and evaluations of Federal financial assistance programs, nor do they limit the authority of any Federal agency Inspector General or other Federal audit official.

b. The provisions of this Circular do not authorize any State or local government or subrecipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits.

c. A Federal agency that makes or contracts for audits in addition to the audits made by recipients pursuant to this Circular shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits include economy and efficiency audits, program results audits, and program evaluations.

11. *Cognizant agency responsibilities.* The Single Audit Act provides for cognizant Federal agencies to oversee the implementation of this Circular.

a. The Office of Management and Budget will assign cognizant agencies for States and their subdivisions and larger local governments and their subdivisions. Other Federal agencies may participate with an assigned cognizant agency, in order to fulfill the cognizance responsibilities. Smaller governments not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them the most funds whether directly or indirectly.

b. A cognizant agency shall have the following responsibilities:

(1) Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

(2) Provide technical advice and liaison to State and local governments and independent auditors.

(3) Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. They should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

(5) Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will be expected to work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for followup action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

(6) Coordinate, to the extent practicable, audits made by or for Federal agencies that are in addition to the audits made pursuant to this Circular; so that the additional audits build upon such audits.

(7) Oversee the resolution of audit findings that affect the programs of more than one agency.

12. *Illegal acts or irregularities.* If the auditor becomes aware of illegal acts or other irregularities, prompt notice shall be given to recipient management officials above the level of involvement. (see also paragraph 13(a)(3) below for the auditor's reporting responsibilities.) The recipient, in turn, shall promptly notify the cognizant agency of the illegal acts or irregularities and of proposed and actual actions, if any. Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets.

13. *Audit Reports.* Audit reports must be prepared at the completion of the audit. Reports serve many needs of State and local governments as well as meeting the requirements of the Single Audit Act.

a. The audit report shall state that the audit was made in accordance with the provisions of this Circular. The report shall be made up of at least:

(1) The auditor's report on financial statements and on a schedule of Federal assistance; the financial statements; and a schedule of Federal assistance, showing the total expenditures for each Federal assistance program as identified in the *Catalog of Federal Domestic Assistance*. Federal programs or grants that have not been assigned a catalog number shall be identified under the caption "other Federal assistance."

(2) The auditor's report on the study and evaluation of internal control systems must identify the organization's significant internal accounting controls, and those controls designed to provide reasonable assurance that Federal programs are being managed in compliance with laws and regulations. It must also identify the controls that were evaluated, the controls that were not evaluated, and the material weaknesses identified as a result of the evaluation.

(3) The auditor's report on compliance containing:

- A statement of positive assurance with respect to those items tested for compliance, including compliance with law and regulations pertaining to financial reports and claims for advances and reimbursements;
- Negative assurance on those items not tested;
- A summary of all instances of noncompliance; and
- An identification of total amounts questioned, if any, for each Federal assistance award, as a result of noncompliance.

b. The three parts of the audit report may be bound into a single report, or presented at the same time as separate documents.

c. All fraud abuse, or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, should normally be covered in a separate written report submitted in accordance with paragraph 13f.

d. In addition to the audit report, the recipient shall provide comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

e. The reports shall be made available by the State or local government for public inspection within 30 days after the completion of the audit.

f. In accordance with generally accepted government audit standards, reports shall be submitted by the auditor to the organization audited and to those requiring or arranging for the audit. In addition, the recipient shall submit copies of the reports to each Federal department or agency that provided Federal assistance funds to the recipient. Subrecipients shall submit copies to recipients that

provided them Federal assistance funds. The reports shall be sent within 30 days after the completion of the audit, but no later than one year after the end of the audit period unless a longer period is agreed to with the cognizant agency.

g. Recipients of more than \$100,000 in Federal funds shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audits on file and follow up with State and local governments that have not submitted required audit reports.

h. Recipients shall keep audit reports on file for three years from their issuance.

14. *Audit Resolution.* As provided in paragraph 11, the cognizant agency shall be responsible for monitoring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and that agency. Alternate arrangements may be made on a case-by-case basis by agreement among the agencies concerned.

Resolution shall be made within six months after receipt of the report by the Federal departments and agencies. Corrective action should proceed as rapidly as possible.

15. *Audit workpapers and reports.* Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

16. *Audit Costs.* The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal assistance programs.

a. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provision of Circular A-87, "Cost principles for State and local governments."

b. Generally, the percentage of costs charged to Federal assistance programs for a single audit shall not exceed the percentage that Federal funds expended represent of total funds expended by the recipient during the fiscal year. The percentage may be exceeded, however, if appropriate documentation demonstrates higher actual cost.

17. *Sanctions.* The Single Audit Act provides that no cost may be charged to Federal assistance programs for audits required by the Act that are not made in accordance with this Circular. In cases of continued inability or unwillingness to have a proper

audit, Federal agencies must consider other appropriate sanctions including:

- Withholding a percentage of assistance payments until the audit is completed satisfactorily,
- Withholding or disallowing overhead costs, and
- Suspending the Federal assistance agreement until the audit is made.

18. *Auditor Selection.* In arranging for audit services State and local governments shall follow the procurement standards prescribed by Attachment O of Circular A-102, "Uniform requirements for grants to State and local governments." The standards provide that while recipients are encouraged to enter into intergovernmental agreements for audit and other services, analysis should be made to determine whether it would be more economical to purchase the services from private firms. In instances where use of such intergovernmental agreements are required by State statutes (e.g., audit services) these statutes will take precedence.

19. *Small and Minority Audit Firms.* Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular. Recipients of Federal assistance shall take the following steps to further this goal:

- a. Assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable.
- b. Make information on forthcoming opportunities available and arrange timeframes for the audit so as to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.
- c. Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.
- d. Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs and, in such cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities.
- e. Encourage contracting with consortiums of small audit firms as described in paragraph (a) above when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals.

f. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation

and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

20. *Reporting.* Each Federal agency will report to the Director of OMB on or before March 1, 1987, and annually thereafter on the effectiveness of State and local governments in carrying out the provisions of this Circular. The report must identify each State or local government or Indian tribe that, in the opinion of the agency, is failing to comply with Circular.

21. *Regulations.* Each Federal agency shall include the provisions of this Circular in its regulations implementing the Single Audit Act.

22. *Effective date.* This Circular is effective upon publication and shall apply to fiscal years of State and local governments that begin after December 31, 1984. Earlier implementation is encouraged. However, until it is implemented, the audit provisions of Attachment P to Circular A-102 shall continue to be observed.

23. *Inquiries.* All questions or inquiries should be addressed to Financial Management Division, Office of Management and Budget, telephone number 202/395-3993.

24. *Sunset review date.* This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

David A. Stockman,  
Director.

#### CIRCULAR A-128 ATTACHMENT

##### *Definition of Major Program as Provided in Pub. L. 98-502*

*Major Federal Assistance Program*, for State and local governments having Federal assistance expenditures between \$100,000 and \$100,000,000, means any program for which Federal expenditures during the applicable year exceed the larger of \$300,000, or 3 percent of such total expenditures.

Where total expenditures of Federal assistance exceed \$100,000,000, the following criteria apply:

Total expenditures of Federal financial assistance for all programs		Major Federal assistance program means any program that exceeds
More than	But less than	
\$100 million	1 billion	\$3 million
1 billion	2 billion	4 million
2 billion	3 billion	7 million
3 billion	4 billion	10 million
4 billion	5 billion	13 million
5 billion	6 billion	16 million
6 billion	7 billion	19 million
Over 7 billion	.....	20 million

[50 FR 31716, Aug. 6, 1985]

## PART 75—INFORMAL GRANT APPEALS PROCEDURES

### Subpart A—Indirect Cost Appeals

Sec.

75.1 Purpose.

75.2 Scope.

75.3 Definitions.

75.4 Notification.

75.5 Submission to the Regional Director.

75.6 Action by the Regional Director.

AUTHORITY: Sec. 1102, 49 Stat. 647, 42 U.S.C. 1302.

SOURCE: 47 FR 17511, Apr. 23, 1982, unless otherwise noted.

### Subpart A—Indirect Cost Appeals

#### § 75.1 Purpose.

This subpart establishes informal procedures for resolving disputes arising in the negotiation of indirect cost rates and certain other cost allocations (as set forth in § 75.2) that are used in determining amounts to be reimbursed under grants awarded by the Operating Divisions of the Department of Health and Human Services. A grantee must exhaust the procedures set forth in this subpart prior to appealing a disputed issue(s) to the Departmental Grants Appeals Board under Part 16 of this subtitle.

#### § 75.2 Scope.

(a) This subpart applies to all disputes arising from determinations made by a Director, Division of Cost Allocation (DCA), in the Department's regional Offices including, but not limited to:

(1) Indirect cost rates negotiated with colleges and universities, State and local government agencies, hospitals, and non-profit institutions.

(2) Patient care rates and amounts associated with the care of patients participating in research programs supported by the Department.

(3) Cost allocation plans negotiated with State and local units of government other than plans provided for under paragraph (a)(5) of this section.

(4) Fringe benefit rates, computer rates or costing methodologies and other special rates negotiated with colleges and universities, State and local

government agencies, hospitals, and non-profit institutions.

(5) Cost allocation plans with State public assistance agencies as described in Subpart E of 45 CFR Part 95.

(6) Disallowances by the Director, DCA, of costs as described in Subpart E of 45 CFR Part 95.

(b) Notwithstanding paragraph (a) of this section, this subpart shall not be applicable to disputed issues which are appealed to the Armed Services Board of Contract Appeals under a contract with the Department.

#### § 75.3 Definitions.

For purposes of this subpart:

(a) *Grantee* means the agency institution or organization named as grantee in a grant award document issued by an Operating Division of the Department. For disputes involving cost allocation plans, this term also includes a State or local unit of government which includes an agency that is named as grantee in a grant award document and a State agency as defined in Subpart E of 45 CFR Part 95.

(b) Other terms shall have the meaning set forth in Part 74 of this title, unless the context below indicates otherwise.

#### § 75.4 Notification.

Where an agreement cannot be reached between the Director, DCA, and the grantee, the Director, DCA will promptly notify the grantee in writing of the Director's determination. This notification will set forth the reasons for the determination in sufficient detail to enable the grantee to respond and will inform the grantee of its opportunity for reconsideration under this subpart.

#### § 75.5 Submission to the Regional Director.

If the grantee wishes to request reconsideration of the DCA Director's determination, it may submit an application for such reconsideration to the Regional Director. The grantee's application must be postmarked or hand delivered no later than 30 days after receipt of the notification described in § 75.4. The Regional Director, however, may grant an extension of time for submission of the application if the extension